Conference Papers

Volume One:
Major Issues of
Canadian Trade Polic

CANADA AND INTERNATIONAL TRADE

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CANADA AND INTERNATIONAL TRADE

VOLUME ONE:
Major Issues of Canadian Trade Policy

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FOREWORD

As part of the 1983 Learned Societies meetings in Vancouver, the Institute of International Relations at the University of British Columbia and the Institute for Research on Public Policy jointly sponsored an international trade conference. Timed to occur between the meetings of lawyers and economists on one hand, and political scientists and Asian studies specialists on the other, the trade conference brought together the analysis and perspectives of these several disciplines. Topics ranged from the theoretical to the empirical, and regional aspects of international trade were also discussed. The common theme throughout, however, was the public policy implications of the analysis, both in a general and in a specific sense, depending upon the paper and subject.

The conference, consisting of two plenaries, a dinner speech, and 23 papers, was divided into two sections that ran simultaneously. One section was devoted to general international trade and financial issues, the other to Canada-Pacific Rim trading relationships. The papers from both sections have been grouped by subject area in the case of the general section and by regional sub-groupings in the case of the Pacific Rim material. Most of the papers have been published in the accompanying conference volume, while the bulk of the remainder will be published by the Institute under its Essays in International Economics series once they become available. The conference papers have been published under the general editorial supervision of John Curtis of the Institute for Research on Public Policy and David Haglund, who was at the time Assistant Director of the Institute of International Relations at the University of British Columbia and is now with the Department of Political Studies at Queen's University. This essay will provide a succinct summary of the two conference plenaries, the dinner speech, and each of the papers.

Co-operation in the planning and execution of the conference between the two Institutes--one university-based and the other independent--was exemplary. This fact, combined with cross-disciplinary interaction that took place, made the experience most worthwhile for all concerned.

Gordon Robertson

AVANT-PROPOS

Dans le cadre des réunions des Sociétés savantes qui eurent lieu à Vancouver en 1983, l'Institut des Relations internationales de l'université de la Colombie-Britannique et l'Institut de Recherches politiques parrainèrent conjointement une conférence internationale sur le commerce. Insérée entre des réunions de juristes et d'économistes d'une part, et celles des politicologues et spécialistes ès études asiatiques d'autre part, cette conférence allait réunir en un même forum les perspectives et les analyses propres aux quatre disciplines. Les sujets abordés allèrent du théorique à l'empirique, et la discussion porta également sur les aspects régionaux des échanges internationaux. Mais le thème commun autour duquel devaient s'articuler les travaux de la conférence fut l'incidence de l'analyse, tant sur le plan général que particulier, et selon le sujet et la présentation, sur les politiques officielles.

La conférence, qui comprenait deux plénières, un banquet-causerie et 23 exposés, fut scindée en deux salles qui siégèrent simultanément. La première fut consacrée au commerce international et aux questions financières en général, et la seconde aux relations commerciales des pays du bassin du Pacifique. Les textes des exposés présentés dans les deux salles ont été regroupés par domaines dans le cas de l'atelier 'général' et par sous-groupes régionaux dans celui du bassin du Pacifique. La majorité des exposés ont été publiés dans le recueil des actes de la conférence; quant aux autres, ils seront pour la plupart publiés par l'Institut dans sa série 'Essais sur l'économie internationale' dès qu'ils seront disponibles. Les actes de la conférence furent publiés sous la direction générale de John Curtis, pour l'Institut de Recherches politiques, et de David Haglund, qui était à l'époque directeur adjoint de l'Institut des Relations internationales de l'université de la Colombie-Britannique et qui travaille actuellement pour le département d'Etudes politiques de l'université Queen's. Le présent essai constituera une brève synthèse des deux séances plénières de la conférence, ainsi que du banquet-causerie et des exposés.

La planification et l'organisation de la conférence furent un remarquable exemple de coopération entre les deux instituts dont l'un a une vocation universitaire et l'autre est totalement indépendant. Et cette collaboration, alliée à l'interaction pluridisciplinaire à laquelle elle donna lieu, produisit une expérience des plus précieuses pour tous ceux qui devaient y prendre part.

Gordon Robertson

SUMMARY

CANADA AND INTERNATIONAL TRADE:
A CONFERENCE SUMMARY

John M. Curtis
and
David Haglund
and
Roman Lepiesza

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CANADA AND INTERNATIONAL TRADE: A CONFERENCE SUMMARY

Panel I: The Western Provinces and Canadian Trade Policy

A general view that the West would have to define more clearly its interests with respect to international trade, and that the federal government would have to show increased sensitivity to western Canadian interests emerged from the opening plenary session. Panelists as well as commentators from the floor focussed in particular on the need for Canada to advocate open world markets into which products of the western provinces could be sold. All agreed that this position was not always clearly and consistently advocated, and that the processes of federal-provincial co-ordination were not perfect, both of which detracted from this objective.

This latter point received particular emphasis from Ed Shaske, who was speaking on behalf of the Government of Alberta. He noted that contemporary western Canadian involvement in Canadian trade policy development dated from the Western Economic Opportunities Conference (WEOC) held during the summer of 1973. International trade had been identified as a priority item for the West at that time and had remained so.

With the creation of the Canadian Trade and Tariffs Committee in 1975 and the inclusion of the provinces on that committee, the West was able to actively promote the case of freer trade. Briefs on agricultural and industrial trade liberalization were prepared in late

1976 and early 1977, and a further comprehensive brief was presented by the Government of British Columbia late in 1977. As well, conferences of western premiers at Brandon in 1977 and at Yorkton in 1978 had taken freer trade positions. At the official level, 1978 was characterized first by a response to the non-tariff barrier (NTB) draft codes and later by the draft subsidy and countervail codes. Finally, in 1979 a provincial liaison committee concerned with trade and the GATT was established. It was followed by a provincial government recommendation that the federal-provincial mechanisms developed during the Tokyo Round be maintained, a proposal that Shaske still supported.

Current issues of trade policy involving both the western provinces and the federal government were highlighted in the panel discussion by Barbara Johnson, who represented the Government of British Columbia. She noted that the Special Import Measures Act before the federal Parliament in the 32nd Session had been the subject of federal-provincial discussion since July 1980. Her concerns and those of her government were related to the lack of transparency in the institutions and processes involved, the fast-trade characteristic of the proposed system for imports, and the apparant lack of concern for both consumer and regional interests. In sum, the proposed Bill appeared to reflect traditional eastern concerns more than western or Atlantic ones.

Johnson was more optimistic with respect to two other current issues: the lumber countervail and the Japanese auto import situation. While federal action with respect to the first had been perhaps somewhat slow and with respect to the second clearly contrary to certain western Canadian interests, the degree of co-operation between the two levels of government even on these issues was quite strong. While co-operation overall might be less formal than had been the case over the past ten years, Johnson added, the parallel interests of the two levels of government in export promotion would ensure ongoing co-ordination.

The third panelist, Professor Ronald Shearer of UBC, emphasized his worry about the weakening of the traditional British Columbia policy thrust of liberalization. While any political jurisdiction pursues basically the same policy of getting as high a price as possible for its exports and paying as low a price as possible for its imports--especially if the competing good can be produced locally--Shearer suggested that British Columbia should be more consistently outward-looking. He even found, from time-to-time, restrictions on goods that the province could not produce.

As for the overall effectiveness of the British Columbia's, and more generally the western provinces', role in national trade policy. Shearer felt that several factors were in play. The current recession was occasionally leading to poor policy decisions, the constitutional division of power did not encourage a national perspective with respect to policy-making, and age-old grievances concerning the cost of the tariff, for example, which had been so well examined in the Rowell-Sirois report, had not been solved.

Panel 2: Canada and the Future of Multilateralism

The second plenary, coming at the end of the conference on the second day, had as its focus the future of multilateralism. Robert Joyce, the Executive Director for Canada at the International Monetary Fund, outlined what he thought was the overall perspective of the Fund at the moment. Perhaps, most important was the growing appreciation of the reality and consequences of economic interdependence. The current international debt crisis involving so many countries, both North and South, made this clear. Also of importance, Joyce added, was the increasing recognition that the state of micro-economic structures and policies determined to a large extent the success of macro-economic performance. Regulatory and labour market systems, for example, had an impact on inflation. In its deliberations and analyses, the Fund was concerning itself increasingly with micro-economic variables.

Third, the perception that change means adjustment was growing stronger. The world economy had clearly undergone major shifts in the 1970s and early 1980s. Those economies that had performed best during that period, and whose outlook was relatively strong now, had demonstrated a particular flexibility in the face of change. Such changes, whether due to technological or other internal or external factors, were a fact of life. They were not a passing phenomenon in the view of the Fund; each country would have to adjust if it wished to profit fully from being a partner in the world economy.

Joyce then drew several conclusions with respect to the world's trade and financial system in the context of the above perceptions. One was the likelihood that international surveillance would increase. Such surveillance would comprise not only exchange rates, already allowed for under Article 4 of the revised Bretton Woods articles, but also interest rates, as well as trade and investment problems. If things developed along these lines, Joyce added, further initiatives would be required to bring finance and trade ministers together. The many historical reasons for separating the two functions, whether for bureaucratic, institutional, or intellectual reasons, were no longer valid or appropriate in today's world. A US initiative to have finance and trade ministers meet had been taken in May 1983 following the OECD Ministerial meeting and more such initiatives were to be expected.

A further implication of the several recent trends referred to by Joyce was the likelihood that eventually there would be better explanations as to why exchange rates floated in certain ways and under what conditions. In addition, improved analysis would soon be available concerning the trade implications of each possible exchange-rate configuration. It was by now well recognized that the operation of the exchange rate was highly relevant to trade policy.

Also of importance in this context was the ability of the trade and finance system to cope with the financing of LDC debts. The opportunity to trade was one important component in enabling the heavily indebted countries to work down their liabilities. Economic growth as well as effective and acceptable adjustment policies in the industrial economies were crucial elements in this trade-related aspect of the global debt crisis. It was yet another reason why finance and trade ministers would have to work even more closely together in the future.

A final point raised by Joyce during his presentation at the plenary was the question of the appropriate multilateral forum for trade and finance discussions. The Fund was one such appropriate place, as trade issues had been continually discussed there for years in connection with the macro-economic performance reviews of member countries, and the GATT was another. Given the stated agenda concerning many items in front of the GATT presently, Joyce thought that adding the international finance component to trade policy analysis already underway at the GATT might be particularly important.

Bill Jenkins, Assistant Under-Secretary of State for External Affairs, stressed in his plenary session the alternative ways that the international trade system could be made to work on an ongoing basis. While his participation at the GATT Ministerial meetings the previous November (1982) had made him more pessimistic than before, he nevertheless remained confident that international co-operation in the trade area would continue.

One method to ensure this co-operation continued would be moral suasion. International agreements would not be binding and their effectiveness would therefore vary. The UNCTAD and the United Nations itself operated on this principle, Jenkins reminded his audience, and so did sections of the GATT and of the IMF.

Another related principle of international economic co-operation was the formation and maintenance of clubs. Participation in the clubs was of course voluntary. Once a country became a member, however, certain obligations had to be accepted, even if they infringed on national sovereignty.

Last, according to Jenkins, were the binding contracts that had characterized the early part of the post-1945 era. While highly desirable, such arrangements were increasingly difficult to negotiate in multilateral fora. Different circumstances and needs made such agreements even less likely in the future.

In one area--that of compensation and retaliatory action in connection with actions taken by trading partners--Jenkins expressed serious concern. This was based not only on the pressure at present to protect, but also on the unilateral actions and counteractions taken and the serious potential for their escalation.

Professor Ted English of Carleton University stressed throughout his presentation a point that he had made many times before: that there was a basic complementarity between multilateralism, regionalism, and even bilateralism. One system need not exclude another; indeed dynamic analysis suggested that sub-global groupings had certain cumulative benefits for the world economic system as a whole. He reminded the audience that the Pacific Rim, for a number of reasons well stated elsewhere, was one such area.

Sidney Weintraub, Dean Rusk Professor of Public Affairs at the University of Texas, stressed the point that all countries seek maximum room for independent action. Yet they all wish to achieve their objectives in the most effective way possible, which at times has meant joining international organizations. In so doing, they accept some limits on national power. In the present context, Weintraub suggested, such willingness to accept international obligations could be used to slow down protectionism. Given present circumstances, however, he could not foresee any scenario by which, for example, a safeguards code acceptable to all could be negotiated. As well, he was nervous about reciprocity talk in the United States. He remained hopeful that Canada-United States preferences consistent with both countries' multilateral obligations could be worked out, although how this initiative might fit into current Washington thinking was a very open question.

John Curtis, the director of the International Economics Program at the Institute for Research on Public Policy was the final speaker. He addressed what he called the new multilateralism. This new system, he envisaged, would evolve from the existing system, encompassing more countries, covering more national policies, and strengthening existing rules and procedures. Like the existing system, it would still ensure that order, predictability, fairness, and freedom characterized international economic relations.

As part of the renewed system, it would be desirable if the maintenance of a healthy trading system became an explicit objective of individual countries' economic policies, not unlike the low inflation, high employment objectives that currently characterized national economic policies. Further, industrial and structural policies, now considered to be entirely domestic, should be made subject to international rules and to supervision by an international authority. Improved procedures for complaints and more continuous discussions, especially at the political level, would also be part of the proposed new multilateral system.

Curtis also stressed the importance of investment performance requirements as part of a rejuvenated system, as well as internationally-accepted norms with respect to the trade in services. He also pointed out that while smaller countries such as Canada had a role in making the system work, one could not diminish the responsibilities that larger countries had. It was often the practices of these large countries that smaller countries emulated.

The brief discussion that followed centred largely on questions of the political environment. One intervention stressed the importance of the market rather than government instruments in helping to solve trade problems. The free trade zones evolving in the United States and Europe provided an example. Another interlocutor cautioned against any grand plans to restore the international trade system--even in the favourable circumstances of 1948, there had been a limit to what could be achieved. Yet another comment from the floor noted the importance of what was termed a "coherent pluralism" in international trading arrangements. As long as various organizational set-ups were consistent with broader, established principles, they should be encouraged.

Dinner Speech: Prospects for the World Economy

The speech given by Robert Johnstone, the federal Deputy Minister of International Trade and Co-ordinator of International Economic Relations, stressed both the interconnected nature of the world's current economic problems as well as the view that the existing international economic system needed strengthening rather than overhauling. Johnstone stated that nations for too long had tended to turn inward and that a new commitment to international economic co-operation was needed. In his view, far-sighted and courageous political leadership--as well as far-sighted and imaginative business leadership--were critical at the present time.

Johnstone argued that current macro-economic (including interest-rate) policies, payments imbalances, debt problems, trade-protectionist pressures, and the plight of the very poor countries, reflected in various interconnected ways the inheritance of a fairly long period of mounting disorder in national economies around the world, and in the workings of the world economy as a whole. In order for one to be optimistic about the future, Johnstone suggested that some progress with respect to all five of these problems would have to occur. With respect to macro-economic policies, for example, one would have to be concerned about the prospects for nominal and real rates of interest in the United States. High US and other interest rates could well abort the recovery. But, Johnstone continued, no one outside the United States could or should lecture the Americans on reducing their budget deficit without attacking President Reagan's policies on defence and taxes. Yet such a reduction was essential to permit a reduction in rates. Moreover, authorities in other important countries, especially West Germany and Japan, were loath to adopt stimulative measures, for a variety of reasons.

In Johnstone's view, major payments imbalances were driven by inappropriate exchange-rate relationships, and could only be ameliorated if more convergent economic policies and performance were in place across the OECD countries. Tinkering with exchange rates would not bring about the desirable longer-term equilibrium in the balance-of-payments position of a country.

The third interconnected element of disorder to be overcome, Johnstone continued, is the debt problem of several major developing countries. He argued that success on the first two fronts--those of the macro-economic and balance of payments--would greatly ease the pressures of financing the deficits of LDCs. Nonetheless, he added, these countries must go through very severe periods of adjustment if they are to regain the all-important confidence of the financial community. Management of the debt problem would also require fully adequate resources in the IMF and a further development of the collaboration that has developed among banks and between the banks and the IMF.

Turning to his fourth point, Johnstone commented that trade policy issues, particularly pressures for protectionism, would be tough enough to handle, even on the most sanguine assumptions about growth, exchange rates, and debt. He added that pressures on the trade system had resulted not just from recession but from problems associated with adjustment to change. This change resulted both from the development of new centres of productive power in the world and the related need for adjustment in major sectors of the industrial economies.

Johnstone noted in this connection that on the trading front, as on so many other fronts, the world is a more complicated place than it was in that period after World War Two when the institutional framework of the world economic system was built. During the late 1940s and 1950s, the players were few in number and they shared a common view of what was needed. For many years thereafter, he said, there was a happy parallelism of perceived national interests and the building of an open world system. Now, however, there were more players sharing to a much lesser extent a common view of what was needed. It was much harder to find that happy parallel between perceived national interests and the requirements of an open and disciplined system at a time of widely differing circumstances, in a time of disorder and uncertainty.

Finally, Johnstone reminded the conference of the world's forgotten people, the poorest of the poor. They were forgotten in his judgment because in our concern about low growth, high debt and other issues we have tended to overlook the needs of these peoples and countries. But these people could not be forgotten, he argued; for quite apart from a fundamental humanitarian concern, there were vexing issues of political and social stability, as well as of security, at stake.

To solve the problems of the poor, to alleviate unemployment particularly amongst the young, to ensure our collective capacity to deal with debt problems as they arise, and to lessen pressures for trade restrictions will require good policies, good luck and a good deal of international co-operation, Johnstone concluded. Canada, he added, must remain a full-time player.

The Papers

Canada and International Trade

The conference papers concerned with general trade questions focussed on rapidly changing and increasingly complex international economic and policy environments.

The first set of papers, by Ted Cohn, Lenard Cohen and Paul Marantz dealt with the political aspects of Canadian trade policy. Cohen and Marantz examined Canadian-Soviet trade relations by focussing on conditions in the Soviet Union.[1] The authors did not forecast major changes in Canadian-Soviet trade, although they argued that the Soviet Union is interested in diversifying its trade and expanding its exports.

In his paper on Canadian and Mexican trade policy towards the United States,[2] Cohn addressed directly the growth of new forms of protectionism in the United States and the increasingly active and vocal role the Congress is playing in US trade policy. The focus of the paper was on the mutual lessons Canada and Mexico might learn from dealing with the United States. Cohn dealt with the specific concerns in resolving disputes with, and obtaining special treatment from, the United States. He pointed out that both Canada and Mexico share many common problems in dealing with the United States. Given the importance of the US market, the formation and implementation of US trade policy will continue to play a major role in the trade prospects of Canada and Mexico.

The question of Canada-United States relations, both bilaterally and multilaterally, was further examined in papers by David Cohen and Chris Thomas on the legal aspects of Canadian-US trade. The two papers focus on two sets of issues that have occupied an important place on the agenda of Canada-United States trade relations, especially over the past decade. One set of issues arises from the lack of international rules in the area of competition policy, and the efforts by US courts and government agencies to assert US antitrust jurisdiction over economic activities in other countries. The other set of issues surrounds the growing body of regulations in most countries, including Canada and the United States, governing product standards and consumer protection; the effects of these regulations and product standards on international trade; and efforts within GATT to establish international rules aimed at minimizing barriers arising from these regulations and standards.

Thomas' paper[3] pointed out that while Canadian and US approaches to competition policy were generally similar, there did not exist a more broadly based international consensus on the role of competition in economic affairs. The main focus of the paper, however, was on a series of antitrust determinations by US courts and on policies followed by US antitrust enforcement agencies, which represented efforts to assert US jurisdiction over anticompetitive activities in other countries, even where these activities conformed entirely to the laws of other countries and might even be mandated by their governments. Such extraterritorial assertion of US jurisdiction (which is paralleled by the extraterritorial assertion of US jurisdiction in other areas) had given rise to much friction in Canada-United States relations. In recent years, Canada as well as other countries had adopted or were in the process of adopting retaliatory responses of various kinds. But a lasting solution to problems in this area called for a rationalization of the role of antitrust enforcement in the United States, the development of a broader international consensus on the role of competition in economic affairs and, most important, because it remains the most significant problem, the development of rules of international law concerning the jurisdictional reach of states in an increasingly interdependent world.

David Cohen's study[4] made an important contribution to understanding a particularly complex set of international issues relevant to Canada's trade and other interests. It has been widely recognized that consumer protection regulations and the establishment of product standards can have a large impact on international trade, as these serve as deliberate or incidental barriers to imported products, distorting the flow of trade, and increasing manufacturers' costs. During the Tokyo Round of trade negotiations in the 1970s, a "Standards Code", adopted within the GATT framework by Canada and a group of other countries, aimed to reduce trade barriers arising from the existence of differing or conflicting product standards and the development of internationally accepted standards. One of the main conclusions of Cohen's paper was that a set of common "North American standards" has emerged, largely as a result of the use in Canada of standards written in the United States. One result is that standards requirements and regulations present only minor non-tariff barriers to the flow of bilateral trade. The paper points out, however, that the adoption by other countries of US standards serves to reinforce the expansion of American exports in foreign markets. Furthermore, it suggests that the United States will use the GATT Standards Code, as well as international standard setting bodies such as the International Standards Organization, to export its standards beyond the North American continent. Canada, Cohen suggested, should ensure that Canadian trade interests, and also the interests of Canadian consumers and labour, are protected in the process of establishing international product standards. Another important conclusion of the paper was that because of stricter consumer product liability laws in the United States, Canadian manufacturers face considerably greater risks in exporting to the United States than do American firms in exporting to Canada. The paper also suggests that Canada's bilingual labelling regulations do not represent a significant barrier to imports, nor do they impose any substantial additional costs on imported goods.

The interaction between trade policy and domestic industrial policy was taken up by Professors Don Paterson and Ron Shearer.[5] The authors provided an historical analysis of the role and impact of Canadian trade policy on the industrial structure of Canada from Confederation to the present time. Drawing upon their own empirical work as well as upon studies by others, Paterson and Shearer concluded that Canadian trade policies have been largely ineffective in changing the pattern of trade or the industrial structure in the ways intended; these policies continue to impose economic welfare losses on Canadians.

The authors concluded that Canada should not be the vanguard of the international forces of protectionism. Quite the contrary was true, given Canada's relatively small size and factor and product endowments. The essentially mercantilist concept of national interest in Canada--as demonstrated by bilateral or commodity-specific trade balances, the proportion of exports that are "hight tech", and the proportion of the labour price employed in high quality jobs--was seen as an inappropriate framework for Canadian trade policy.

The papers under the general heading of Canadian Commodity Trade focussed on a study prepared by Michael Webb and Mark Zacher[6] and a study by David Haglund.[7] Both papers attempt to extend research into complex areas of special interest to Canada at a time when there are significant changes in patterns of world mineral production and trade.

Over the post-war period, international agreements to stabilize world markets had been concluded within the United Nations framework for a number of primary products, but not for any of the minerals produced or exported by Canada. As the paper by Webb and Zacher pointed out, most of the negotiations for such agreements since the 1960s had been set in the context of North-South confrontations; and Canada did not fit comfortably into either the group of industrialized importing countries or the group of developing country exporters. Their paper examined separately and in detail the post-1945 record of Canadian government policy towards the adoption of agreements covering six minerals exported by Canada: copper, iron ore, lead and zinc, nickel and uranium. It concludes that Canada has generally been opposed to formal intergovernmental commodity agreements for these products; that Canada has generally rejected participation in cartels among producer countries, but that the government has supported efforts of private industry to manage and stabilize minerals markets. One of the factors that has influenced government policies was that "producer price systems" have prevailed, at least until recently, in Canada's main export markets for minerals products, notably the United States, providing Canadian exporters with somewhat higher and more stable prices than those prevailing in other export markets that lacked effective management by private producers. Another factor has been the opposition to formal intergovernmental commodity agreements by private Canadian producers of all the minerals concerned, with the exception of uranium. Canadian producers, however, have co-operated in informal international arrangements for information sharing and consultations among producing and consuming countries.

Other factors influencing government policies, Webb and Zacher concluded, have included difficulties of co-ordinating federal and provincial interests involved, opposition to such agreements by other industrialized countries, especially the United States, and doubts about economic benefits for Canadian private producers. The paper calls for a closer dialogue in the future between Canada and less-developed exporting countries on possible collaborative market strategies.

David Haglund's paper examined the concerns major industrialized countries have expressed over the past decade about the security of their raw-material supplies, especially of so-called "strategic minerals" such as oil from the Persian Gulf, and a range of metals: cobalt, chromium, manganese, the platinum group metals, and vanadium, the production of which is concentrated in southern Africa. The study finds that recent Western concern for mineral security is not likely, at present, to translate into major direct gains for Canada as a minerals exporter. Canadian production of cobalt and the platinum group metals cannot be appreciably increased unless production of nickel and copper is expanded, and Canada has no production of chromium, manganese or vanadium. Chromium production could conceivably get under way in Canada in the 1980s, but would require subsidization either by Ottawa or by Washington. Washington, Haglund stated, is more likely to subsidize the development of chromium resources in the United States.

Rodney Grey, former Canadian ambassador to the GATT, extended the discussion on trade rules by addressing the question of the appropriateness of the GATT as an instrument for dealing with trade in services.[8] As a new but rapidly growing area in trade, service trade does not fall under the explicit regulation of the GATT. Grey examined the major principles and rules of the GATT with respect to their possible applicability to dealing with the major horizontal policy issues in trade in services. He concluded that it would be inappropriate at this time to attempt to integrate trade in services into the current GATT structure. He further concluded that the top priority for the GATT was to strengthen the existing rules and to address the outstanding issues such as safeguards in the area of industrial goods trade.

The interdependence between trade issues and international monetary issues was the theme of the last session on general trade issues. Debra Glassman examined the impact of Canadian dollar futures trading on the Canadian exchange rate, focussing on the policy implications for managing the Canadian dollar.[9] She noted that generalized floating of exchange rates from the early 1970s onward had brought two major surprises. One was that floating exchange rates did not provide the complete insulation of the domestic economy from external influences that theoretical writings of the 1950s and later had suggested. Secondly, exchange rates under a floating regime fluctuated far more than most analysts expected.

Because there was now enough data available to begin to evaluate the floating rate experience, Glassman was able to begin answering the question of whether the exchange rate volatility observed could be blamed on destabilizing speculation. She found, on the basis both of her own work and that of others, that the evidence on foreign-exchange market efficiency is not conclusive. The sensitivity of the results to different kinds of tests, different estimating procedures, and different choices of test statistics was disturbing. Further, there was some evidence that inefficiency was associated with certain time periods when foreign exchange markets are active or volatile. As well, she found that inefficiency may be a short-term phenomenon, lasting only a few days or weeks.

Glassman concluded that whether or not there had been excessive exchange rate volatility and/or destabilizing speculation under managed floating remained an open question. The extent of central bank intervention and frequently voiced concerns about the degree of volatility indicate, she concluded, that public officials at least are not happy with the fluctuations. Many corporate treasurers had been kept busy devising strategies to hedge exchange risk and reduce foreign exchange exposure. This had become a big business, and a costly one. The resources expended in these activities would be free for other purposes if exchange rates were more stable and hence more predictable.

Bob Paterson and Michael Hicks[10] addressed under the same heading the issue of export financing and in particular the problem and policy alternatives facing Canada in this critical area of commercial policy. They reviewed the history of official export finance, including an evaluation of the Canadian Export Development Corporation, and noted that the international regulatory regimes--the Berne Union of 1934, the Article XVI provisions of the GATT, and the 1978 OECD Agreement on Guidelines--were all very underdeveloped. Since the international legal status of such regimes was very weak, export subsidies generally were not subject to countervailing duties. Private complaints about foreign export credits in breach of domestic law were subject, however, to a structured and formalized system in the United States, as evidenced in the Bombardier case, and to a much less formal system in Canada.

Overall, Paterson and Hicks found that no cases of government involvement in export financing were identical. Because all major exporters were competing for identical markets, it was not surprising that a degree of uniformity in practices had emerged. Still, the authors concluded, there remained major problems related to official export financing, none of which is susceptible to a simple solution. In the Canadian case, the EDC faces many domestic pressures to match the terms of foreign agencies, pressures which are exacerbated by the complex international legal aspects of the export credits problem.

John Curtis discussed Canada's involvement and positions on international monetary issues.[11] He noted that little of what has been written in recent years about the international financial system in general, and the International Monetary Fund (IMF) in particular, has had a Canadian focus. This fact was all the more surprising, he thought, given the long and continuous Canadian involvement in the system since its founding in 1944, and given the Canadian public's almost daily fixation with the Canada-United States exchange rate. Further, the Canadian debate on international financial policy and institutions has been essentially a private one, a situation unlikely to change until information and analysis done by the very few agencies involved become more widely available.

Curtis added that since the collapse of the Bretton Woods fixed exchange rate system, the level of the exchange rate had become a major international trade issue. From the limited amount of publicly available material, he found that over the years the Bank of Canada had always vehemently opposed any deliberate devaluation of the Canadian dollar. The Canadian government's position, in contrast had been more ambiguous.

Canada and the Pacific Rim

The conference papers concerned with Canada-Pacific Rim trading relationships focussed on recent economic developments in the diverse, dynamic region of the West Pacific littoral, often referred to as the Asia-Pacific Basin. Developments such as the emergence of China, and more than 15 years of rapid economic and trade growth of several Pacific Basin countries provided a most illuminating backdrop to an active discussion of the mounting economic opportunities and challenges facing Canada in its relationships with Asia-Pacific countries in the 1980s. A total of 12 papers were presented in six separate sessions: two on Japan, two on China, three on Southeast Asia, and one each on the newly industrializing countries of East Asia, joint ventures, fisheries arrangements, organizational ties, and economic change in the Asia-Pacific region.

Professor Frank Langdon addressed the issue of Canada and the internationalization of the Japanese economy.[12] The Japanese concept of "internationalization" has been given strong support by Nakasone's government, and implies mostly the liberalizing of the Japanese economy, combined with an emphasis on more Japanese investment abroad. In spite of the publicity surrounding these changes, Langdon suggests that, due to the inherent competitiveness of Japanese production, the impact of liberalization on Japan's trade with the West will be marginal.

With respect to Canadian trade with Japan, Langdon points out that Japanese liberalization efforts have resulted in virtually no change. Though tariff-related difficulties remained, it is the demanding nature of the Japanese market which is particularly problematic for Canada. Thus, though new opportunities have been opened up in the service sector of Japan, Canada's potential is limited by competition from third parties. Consequently, Canadian trade remains dependent on large exports of natural resources. Even in this sector, however, Canada's position is threatened, not only by changes in demand resulting from the economic restructuring being undertaken by the Japanese but also by competition from other suppliers. Moreover, Japanese investment in Canada remains relatively small, and any sharp increases would likely occur in the energy sector.

In summary, Langdon concludes that, though Japanese "internationalization" opens new opportunities for Canada, these are small and will require strong Canadian efforts to be fulfilled.

A somewhat different perspective on Japan's internationalization process was presented by Malcolm Smith. Focussing on the legal and administrative changes which have occurred in Japan over the past five years, Smith sought to identify the type of legal model employed in Japan, so as to further understand the fundamental operations of Japan's economic system and particularly the mechanism of the internationalization process.[13] Two opposing systems within the legal framework were discussed; the legalistic framework with its well-established set of rules (laws regulating foreign investment and foreign exchange transactions as well as domestic laws which have an impact on trade) and the discrectionary framework, consisting of certain practices whereby intervention occurs at the institution's discretion. In contrast to the rigid legalistic framework, the discrectionary framework is characterized by speed and ease of use.

After citing similarities in the broad, vague wording of legislation in both Japan and Canada, wording which he claims leaves the door open for intervention, Smith concluded that over the past few years, Japan's legal framework has been shifting from the discretionary to the legalistic, thus shifting in the direction of trade liberalization. However, Smith warns that recent trade friction between Japan and its major trading partners is pushing the Japanese administration back to the point of using discretionary practices rather than moving it forward to a more transparent legalistic framework.

With respect to format, the China session broadly paralleled that of Japan. The first paper dealt with trade-policy issues while the second focussed on the emergence of contract law in the People's Republic of China. Samuel Ho and Ralph Huenemann, co-authors of the trade paper, outlined developments in China's "open door policy", a policy which has been designed to attract much needed foreign technology to shore up major gaps in China's manufacturing industry and infrastructure.[14] China's open door policy therefore marks an historical turning point in that China now welcomes long-term investment; in order to attract foreign technology and investment, a wide variety of special trade instruments are now being used, including equity joint-venture, compensation trade and processing and licencing arrangements.

Ho and Huenemann note that before China's open door policy becomes a viable alternative to the country's long-standing policy of self-sufficiency, China's economy must undergo a period of adjustment during which two major issues must be resolved. The first issue concerns an ideological debate over the appropriateness of pursuing sectorally-balanced versus unbalanced growth as a vehicle for domestic economic development. Balanced growth favours the sectors of agriculture and labour-intensive manufacturing while unbalanced economic development would necessitate extensive investment in heavy, capital-intensive industries. The second issue centres around the need for reforms in China's resource-allocation mechanism so as to better absorb and pay for foreign technology. The authors outline a number of structural economic and institutional constraints which hamper China's overall modernization process in general, and the open door policy in particular, and conclude that the real test of whether China will attract, assimilate and absorb a significant amount of technology and capital is about to begin.

Just as the open door policy marked an historical turning point in China's economic evolution, so did China's policy decision to establish a body of contract law set new precedents. It is historical in that communist China is, for the first time according to Robin M. Elliot, attempting to guarantee equity through the legal system.[15] China is seeking therefore to establish a system of government that is based far more than it ever had been on the rule of law. The introduction of contract law in China reflects a changing economic system, in which decentralized elements have responsibility for putting broad plans into effect.

Within this context, Elliot notes that the Economic Contract Law plays a number of different roles. It provides a framework of rules for the conduct of business activities involving products and items not covered by long- and short-term economic plans. It ensures that those plans will be put into effect, by enforcing that contracts be consistent with the targets set by the mandatory plans. It also makes clear that enterprises that do not live up to their contractual obligations will be liable to penalty payments and damages to be paid out of profits. It encourages, therefore, greater operating efficiency and care. Elliot cautions, however, that one should not assume that all economic dealings in China are now being conducted in strict accordance with the provisions of the Economic Contract Law. In fact, the implementation process has been, and will continue to be, a gradual one, with the large enterprises in the major centres being the first to be brought within its scope and the smaller enterprises in the smaller centres likely to be the last. Throughout the paper, Elliot looks at contract law under its various articles: formation of contract law, variation and cancellation, liability for breach, dispute resolution, and management of economic contracts, all areas of interest to the foreign investor.

In a session entitled "Canada and the Pacific Rim: East Asian NICs", Roy Matthews examined Canada's trade relationships with the newly-industrializing countries (NICs) of East Asia, South Korea, Hong Kong and Taiwan. His presentation was a capsule summary of a larger study published by the Institute for Research on Public Policy earlier in 1983.[16] According to Matthews, the economic story of the three East Asian states is actually a replay of the Japanese experience, but at a much lower level of industrial sophistication and narrower scope of trade diversification, at least for the present. Central to the discussion is an outline of the mounting opportunities and challenges surfacing in the East Pacific region. Matthews envisages an increase in trade in a market that is not enormous but one that has been rapidly growing and has inherent potential to run ahead of most other countries. Matthews expects a wave of competition from East Asia's NICs as they move up-market, producing higher value-added export goods. But unlike past competition, which affected Quebec's clothing industry, this next competitive wave will hit Ontario. The so-called "New Japans" will present Canada with mounting challenges. Matthews' underlying theme is that there will be the need to refrain from protectionist tendencies and face necessary economic adjustment.

Three papers dealt with Canada-Southeast Asia economic relations. One paper centred on Canada-Indonesia economic relations, the two others on a group of countries joined in a quasi-economic organization, the Association of Southeast Asian Nations (ASEAN), whose members are Indonesia, Singapore, Thailand, Malaysia and the Philippines. In his paper on Canada-ASEAN economic relations, Donald Crone noted that the focus of Canadian policy in Southeast Asia has shifted both in nature and interest, from one based narrowly on Commonwealth and regional security concerns to one based on economic considerations. This has led to a broadening and deepening of ties with the region.[17] Canada's trade and aid relationship with ASEAN has risen and there are attempts to build a wider relationship with ASEAN through various co-operation programs; it is hoped that such developments will eventually transform the nature of the existing relationship, which is based largely on aid, to one based more on trade.

In Crone's view, ASEAN is attempting to diversify its economic base and relationships with other countries so as to lessen the influence of its major trading partners, the United States and Japan and, to some extent, to lessen the influence of the bigger powers of Europe, notably the recent colonial masters. According to Crone, the base for future Canada-ASEAN relations is a common search for a third option strategy. This base is reinforced by a degree of complementarity between Canada and ASEAN with respect to levels of economic development and the potential mutual benefits of economic co-operation.

On the topic of Canada-ASEAN economic relationships, Keith Hay and Donald Lecraw outlined in their study the economic successes of, as well as the prospects and opportunities for, the five ASEAN countries.[18] Hay indicated that for almost two decades the economic structure of ASEAN has undergone a transformation. Agriculture as a proportion of total output in the various ASEAN countries has been steadily falling, while secondary industry and labour-intensive and service industries have been rising in significance. Approximately one quarter of total exports now stem from the output of the manufacturing sector, a significant feat considering that not long ago ASEAN trade was almost completely dominated by raw resource products. According to Hay and Lecraw, economic growth and the transformation process in ASEAN has been constrained by balance-of-payments problems in recent years, a condition that is determined by external factors beyond their control. Although the Canada-ASEAN relationship will be influenced by these conditions, prospects for Canada will remain reasonably bright owing to a relatively strong demand in ASEAN for the goods and services required to develop substantial resource endowment, infrastructure systems and a broad manufacturing base. The challenge for Canada is to find ways to penetrate the ASEAN market while at the same time opening up to the labour-intensive products from ASEAN countries, a process which will involve domestic economic adjustment.

Geoffrey Hainsworth examined the main components and trends in Canada-Indonesia economic relations over the past 15 years or so and sought to discern the potential for more mutually beneficial relations in the years ahead.[19] Since it is a major "country of concentration" for Canadian bilateral aid, there has been substantial subsidization of Canadian exports, consultancy and investment in Indonesia. Canadian firms have not fared well in competition with other suppliers in bidding (for example, for World Bank and Asian Development Bank contracts), and Canadian polices to stimulate self-sustaining exports and joint ventures under the Program for Export Market Development and CIDA's Industrial Cooperation programs have been disappointing. This has led many observers, notes Hainsworth, to question whether Canadian firms, other than half a dozen multinationals, have the skill and fortitude to extend their operations or even hold their own in what is likely to become an increasingly complex and demanding arena.

In seeking a more positive assessment, Hainsworth attempts to identify within Indonesia's development priorities those sectors in which Canadian expertise and comparative advantage are most likely to be secure and to assess how far such "beach-heads" might provide entry for more extensive Canadian participation. Indonesia has a strong propensity toward linkage and packaging when it comes to negotiating components of its foreign economic relations, as in the recent "counter-purchase" requirements in government procurement contracts. Canada's current reorganization of its External Affairs department appears to offer a counterpart negotiating strategy. This bilateral approach may also give Canadian firms more preferential access to Indonesian opportunities than they could acquire through isolated competitive bidding. Whether Canadian taxpayer and consumer interests are best served by such politicized relations is another matter. Some final observations are offered on potential complementarities in future Canadian and Indonesian development, on what it might take to stimulate a broader range of trade and joint-venture operations without the need for ongoing subsidy and on preferential treatment.

The next session on Pacific Rim developments dealt with two broad issues of significance to Canada: the changing economies of the Asia-Pacific region and their impact on Canada; and Canada's interest in forming stronger organization ties with the countries of the Pacific Rim. Roman Lepiesza of the Institute for Research on Public Policy, outlined some of the major structural economic changes currently taking place in the Asia-Pacific basin.[20] Lepiesza noted that since the 1960s the export-oriented countries of the Asia-Pacific have been transforming their economies by shifting output increasingly towards higher value-added production. For many, particularly the resource-rich countries, transformation has meant a significant shift in the structure of output and export from agriculture to manufacturing, while for others such as Japan it has meant a shift in output from the trailing to the leading edge of industrial development worldwide.

Such structural change, which occurred within the span of a single generation, created numerous opportunities as well as challenges for Canada. Exports of Canadian resource products grew rapidly to fill the growing need in the Asia-Pacific region, while imports from there had a significant competitive impact on central Canada. In recent years, however, Lepiesza noted, many of the countries of the Asia-Pacific region have altered their economic structures and trading patterns in response to changes in the international economic environment. The trend in trade within the Asia-Pacific region and with Canada is towards increased imports of fabricated and end products. Japan's demand for raw material resources, for example, has been levelling off and despite increased imports of more fabricated forms, Japan's share of Canadian exports has fallen by 20 per cent since 1977. The share of trade with the resource-rich developing countries of the region has increased and their growing demand for components, technology and capital goods in combination with a changing pattern of import demand in Japan has significant implications for Canada's export prospects as well as for its role in the region's trade. Canada will find it increasingly difficult to penetrate the dynamic Asia-Pacific market, Lepiesza concluded, unless it can quickly diversify its export products from both western and central Canada. As a policy response to the Asia-Pacific economic challenge, Lepeisza suggests a more encompassing export promotion program involving imports as well as exports.

Paralleling Canada's growing ties with the Asia-Pacific Basin has been its interest in a Pacific Community, a concept which calls for the formation of closer economic and other organizational ties with countries not only of the region but also on both sides of the Pacific, including the United States. Michael Fry and Keith Hay note that such a community would require significant measures of commitment, integration and surrender of sovereignty by member countries.[21] Within this framework, the authors question whether the pre-conditions for forming a Pacific Community theoretically exist and, if so, whether the trends are positive. In their paper, Fry and Hay consider factors that tend to increase significantly the interaction levels among countries, with the assumption being that these interactions will foster expectations of reciprocal benefits stimulative of regional or community behaviour. Using an economic approach to community involvement, Fry and Hay indicate that all potential Asia-Pacific community members will have a differing calculus upon which to measure the likelihood of their adherence to a community that would demand more commitment, integration and denial of sovereignty. Despite mounting economic ties with it, the sum total of our current involvement in the Asia-Pacific region, according to Fry and Hay, makes it look as if the area is still at the margin of our economic and strategic thinking. In this regard, the best policy option available to Canada in the medium-term may be the formation of a trading bloc with the United States rather than a larger Pacific Community, which Fry and Hay regard as interesting only as a longer-term alternative.

In the final session of the conference, two papers, for the most part unrelated to each other, were presented under the broad theme of co-operation through self-interest. The first paper by J.W.C. Tomlinson, Ilan Vertinsky and C.F. Smart outlined the nature of the joint-venture mechanism of technology transfer to developing countries.[22] Their study focussed primarily on the structure of joint venture, the reasons for going into such an arrangement, major issues to consider in the formation of a joint venture, and the limitations of the joint-venture format as a mechanism for the international transfer of technology. The authors reveal that from the foreign investors' point-of-view, joint venture can be desirable for a number of reasons, including complementarity of local resources and facilities, host government incentives, risk spreading, return on investment, entry into a market or attaining a certain level of market share. From the recipient country's point of view, the joint-venture mechanism is often viewed as a major vehicle not only for the sake of investment and employment but also to educate and train its workforce in several technical and management fields. Although there are several costs and benefits associated with this mechanism of technology transfer, the authors, after reviewing the results of a number of case studies on Latin American countries, conclude that there is a "commonality" of mutual interest between the transferer and the recipient of technology in a joint-venture arrangement. Tomlinson and Vertinsky view this commonality as a commitment which points to a convergence in the attitudes of both experienced foreign investors and host-government authorities vis-à-vis the positive nature of joint venture in general, even if their motivations may be different.

The final paper, by Gordon R. Munro, focussed on the economics of co-operative fisheries arrangements. The Third Law of the Sea Conference has had a major revolutionary impact upon the management of world fisheries. Coastal states such as Canada have, as a consequence of the conference, acquired control over large fishery resources which hitherto lay beyond national jurisdiction. Thus, one can maintain that the Law of the Sea Conference has created a new set of potential trade relations for Canada and other coastal states.[23] Key policy questions in this regard are being debated, such as whether Canada should co-operate with other nations to manage and develop these resources or whether it should seek to Canadianize the industry. Seeking an answer to this question, Munro examines the economics of co-operative fisheries arrangements, which he defines as a blend of economic fisheries management and international trade considerations.

The economic arguments in favour of co-operative arrangements, according to Munro, prove to be no more than variations on the argument for free trade. Similarly, the arguments from within the coastal states against the arrangements are seen upon inspection to be an argument in favour of protecting various sectors of the coastal-state fishing industry. Munro noted that Canadian policy towards co-operative fisheries arrangements has, from the inception of extended fisheries jurisdiction, tended to be strongly protectionist, in large measure attributable to the strength of the employment argument for protection in Atlantic Canada, the region most heavily influenced by extended fisheries arrangements. Yet protectionism can also be attributed to the common property nature of the fisheries, a property which has acted as a constant and ongoing ban to the effective management of fisheries.

Summary and Conclusion

Overall, a number of central issues emerged in both plenaries, in the dinner speech and in all the papers, reflecting the interdependence of the global economic system, the high level of government involvement and intervention in the domestic economies, and the shrinking distinction between the domestic and the international policy spheres. The prime concern echoed throughout was the need to strengthen the existing rules and to extend international co-operation to new areas currently outside the explicit regulation of existing institutions in order to reduce uncertainty and instability in the international trading system. Underlying this concern was the recognition of the interdependence of trade issues as well as those issues involving trade, international investment, exchange rates, and global debt. Canada has a major role to play in this area, as well as some major decisions to make in coming years.

Notes

1. Lenard J. Cohen and Paul Marantz, "Soviet-Canadian Trade: The Politics of Inter-Vulnerability", Chapter 2, Canada and International Trade.
2. Theodore Cohn, "Canadian and Mexican Trade Policies Towards the United States: A Perspective from Canada", Chapter 1, Canada and International Trade.
3. J. Christopher Thomas, "Conflict Over the Extraterritorial Application of US Antitrust Law: A Canadian Perspective", Chapter 4, Canada and International Trade.
4. D. Cohen, "The Intersection of Consumer Protection Law and International Trade: Implications for Canadian Regulators", Chapter 5, Canada and International Trade.
5. Kenneth D. Freeman, Donald G. Paterson and Ronald A. Shearer, "Commercial Policy and the Industrial Structure: An Historical Perspective", Chapter 3, Canada and International Trade.
6. Michael Webb and Mark Zacher, "Canada and International Regulation of Primary Commodity Markets: The Case of Minerals", Chapter 6, Canada and International Trade.
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8. Rodney de C. Grey, "Canadian Service Industries in the World Economy", A Paper Presented at the IIR-IRPP Canada and International Trade Conference, Vancouver, 6 June 1983.
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11. John M. Curtis, "Canada, the International Monetary Fund, and

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12. Frank Langdon, "Canada and the Internationalization of the Japanese Economy", Chapter 11, Canada and International Trade.
13. Malcolm Smith, "The Internationalization of the Japanese Economy: The Legal Framework", Chapter 12, Canada and International Trade.
14. Samuel P.S. Ho and Ralph W. Huenemann, "China's 'Open Door' Policy", Chapter 15, Canada and International Trade.
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20. Roman Lepieza, "Canada and the Changing Economy of the Asia-Pacific Basin", (Institute for Research on Public Policy, forthcoming).
21. Michael Fry and Keith Hay, "Canada and Organizational Developments Among Pacific Rim Countries", A Paper Presented at the IIR-IRPP Canada and International Trade Conference, Vancouver, 5 June 1983.
22. J.W.C. Tomlinson, I. Vertinsky and C.F. Smart, "Transfer and Control of Foreign Technologies: Policy Analysis and a Latin

American Case Study", Chapter 18, Canada and International Trade.

23. Gordon R. Munro, "Canada, International Trade, and the Economics of Co-operative Fisheries Arrangements", Chapter 17, Canada and International Trade.

MAJOR ISSUES OF CANADIAN TRADE POLICY

1: CANADIAN AND MEXICAN TRADE POLICIES TOWARDS THE UNITED STATES: A PERSPECTIVE FROM CANADA

Theodore Cohn

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CANADIAN AND MEXICAN TRADE POLICIES TOWARDS THE UNITED STATES: A PERSPECTIVE FROM CANADA

Introduction

The United States shares long, relatively open, borders with both Canada and Mexico and as a Mexican foreign minister once said to his Canadian counterpart, "Our two countries are united by one common problem."[1] Many policy-makers and academics, however, are skeptical that even the US connection provides a basis for comparison or collaboration between Mexico and Canada. In a study co-ordinated by Robert L. Paarlberg, for example, one author concludes that "differences in the bilateral relationship (Mexican-US versus Canadian-US) are more important than the similarities."[2] Canadian-US linkages are viewed as approximating the Keohane-Nye complex interdependence model, while "US relations with Mexico, despite some similarities to the Canadian case, fall closer to simple conditions of 'dependence'."[3]

The most fundamental difficulty in comparing Canada and Mexico is the marked difference in their economic development levels. An examination of development indicators such as per capita GNP, industrial and agricultural capacity, infrastructure and human resources clearly reveals more Canadian similarities with the United States than with Mexico. The President of El Colegio de México, Víctor Urquidi, has noted that Canada is:

> an industrially and technologically developed economy, with a rich agriculture and a large resource base. A comparison with Mexico should not. . .lead to the fallacious conclusion that both the Canadian and the Mexican economies are part of the breed of 'developing economies'. . . .[4]

The divergencies between Canada and Mexico are undeniable, as are their differences in degree and nature of dependence on the United States. We maintain, nevertheless, that a comparison of US relations with its two neighbours can be of considerable value to students and practitioners of Canadian foreign policy. The countries' agenda of economic concerns are strikingly similar in some respects, as demonstrated by various bibliographies and working papers.[5] Although Mexican-US border issues such as immigration have no significant parallels in a Canadian-US context, comparisons can be drawn in other areas including foreign investment, trade, energy and maritime issues.

Similarities also exist in the overriding importance of the United States to its two neighbours. Although asymmetry is considerably greater in the Mexican-US case, Keohane and Nye underestimate the asymmetrical nature of American relations with Canada. Their complex interdependence model obfuscates some of the costs to the smaller country in a relationship:

> The American rhetoric of interdependence has taken on some of the qualities of an ideology. The word 'interdependence' subtly obscures the inequalities of national capability, pleasingly points to a reciprocal dependence, and strongly suggests that all states are playing the same game.[6]

Asymmetry is evident in major economic areas such as foreign investment, trade and technology. For example, both Canada and Mexico conduct about two-thirds of their foreign trade with the United States; in contrast, only 16 per cent of American exports are normally directed to Canada and 7 per cent to Mexico.

Reflecting this asymmetry, Canada and Mexico are sometimes described as countries that "do not engage the continuing attention of top-level policy-makers in Washington but rather are only intermittently the focus of concern."[7] The United States periodically takes actions directed primarily at its principal competitors--the European Community and Japan--which can have potentially damaging consequences for its neighbours; witness President Richard Nixon's imposition of a 10 per cent import surcharge in 1971.[8]

Receiving greater attention from the United States can, on the other hand, be a mixed blessing for its neighbours. With the relative decline in its economic power, the US has been less willing to make sacrifices as leader of the Western economies and has more aggressively pursued its national interests. Increased pressure has been imposed on Canada and Mexico to liberalize trade and investment flows--for example, on Mexico to join the GATT) and on Canada to dismantle (or at least significantly alter) its Foreign Investment Review Agency. At the same time, the United States--not unlike the West Europeans and Japanese--has resorted more frequently to "the new protectionism" in trade. The periodic tendency in Canada and, to a greater extent in Mexico, to adopt nationalist measures for domestic political as well as economic reasons has further contributed to conflict with their common neighbour. Recent examples include Canada's National Energy Program and nationalization of the banks in Mexico.

In some respects, the United States is devoting greater attention to Canada and Mexico, partly because of its search for reliable sources of energy and other resource imports, and partly due to the development of regional trading blocs such as the European Community. Thus, Senator Pete Domenici stated before a US subcommittee hearing in October 1979:

> For so long, we have considered America's relationship of a trade nature and otherwise with foreign countries and we have always looked far, far away, and I truly believe that for this country. . .to remain economically sound, that we have to look at this continent.[9]

Conclusions about greater US attention, however, should not be overdrawn. Even when interest is explicitly expressed in Canada and Mexico, indications persist that they are "only intermittently the focus of concern". Senate Resolution 165 introduced in 1979, for example, called for the US President to "enter into negotiations with the

Government of the United Mexican States and the Government of the Republic of Canada to establish a North American Continental Trade Commission."

Canada is repeatedly referred to incorrectly as a "Republic" in the resolution.[10] As for Mexico, the Reagan administration is deeply concerned that instability in Central America might spread to its southern neighbour. However, Mexico's proposed remedies (presented individually and as part of the "Contadora" group) have received little serious US consideration.[11]

Administrative reorganizations in the US government might be indicative of heightened attention, but should also not be over-estimated. The Canadian desk in the European Bureau of the State Department was elevated in the late 1970s to the level of a deputy assistant secretary. From one perspective, this change might have reflected "the importance of. . .[the US] relationship with Canada",[12] but from another, the move "was undertaken in some degree to compensate for the decline in knowledge of and support for Canada among senior echelons in the State Department."[13]

Conclusions about Canada's elevated position must also be tempered by the State Department's weakened position in the US federal bureaucracy, and by some shifting in international economic policy-making from the executive to the congressional branch.

As for Mexico, the American President in a memorandum dated 26 April 1979, stressed the requirement "to improve our ability to address effectively all issues which affect US relations with Mexico."[14] To achieve this, the unprecedented step was taken of appointing an Ambassador-at-Large and Co-ordinator for Mexican Affairs; the individual was to assist the President and Secretary of State in development, co-ordination and implementation of policies toward Mexico. The first co-ordinator, Robert Krueger, has provided a degree of cohesiveness in US policy but, although influential, he has not been a "determinant player in the federal bureaucracy". In a number of instances, US government agencies have circumvented or rebuffed the co-ordinator.[15]

In summary, Canada and Mexico have highly asymmetrical relationships with their common neighbour, even though asymmetry is clearly greater in the Mexican case. US attention to (and conflicts with) these countries has increased in certain economic areas, but lack of interest and knowledge concerning them is persistent. The agenda of Canadian and Mexican economic concerns with the United States bear some striking similarities in such areas as foreign investment, trade and energy policy.

Policy-oriented studies of possible areas of comparison and collaboration between Canada and Mexico in their US relationships should be encouraged. Issues could thereby be identified that are most conducive to bilateral co-operation (Mexican-Canadian as well as each country's relations with the United States), trilateral interaction and a multilateral format. However, a major obstacle to such studies stems from traditional Canadian linkages and attitudes. In this monograph, we will first provide an assessment of Canadian scholarly and government attention to a "trilateral focus" in North American relations, with particular emphasis on trade. We will then take a more detailed look at foreign trade as one issue that requires further study in a North American context.

Canadian Interest in a "Trilateral Focus"

Professor J.C.M. Ogelsby begins his book, Gringos from the Far North, with the observation that Canadians "deny Mexico its place in North America, so absorbed have they been with their own development and the power and influence of their immediate neighbour, the United States of America."[16]

Canada's bipartite perception of North America stems largely from the fact that its traditional linkages--politically, economically and culturally--are with Western Europe and the North Atlantic region. Certainly the orientation of Canadian society strikes a sharp contrast with the Latin American heritage and culture of Mexico. Thus, John Holmes has stated "There are arguments for attaching. . .[Canada] to various regions or groups of states. If there is one region, however, to which Canada does not naturally belong, it is the so-called Western Hemisphere."[17]

Canada's view of its separateness from Latin America has been reinforced by the preoccupation with domestic differences between its English- and French-speaking communities. John Harbron has noted:

> As recently as 1972, an ambassador from a Spanish-speaking Caribbean country in Ottawa despaired openly to the author about the bias against 'Latins' that he sensed in his dealings with the Department of External Affairs. . . . As long as the domestic relationship between English- and French-speaking Canadians has not been resolved, relations with more distant Latin communities will not always proceed smoothly.[18]

Canadian feelings of distinctiveness have been additionally encouraged by the general lack of interest and knowledge about Canada in most of Latin America, including Mexico.

Emphasis on differences is also based upon divergent levels of economic development. Canada is classified as "industrialized" with a per capita GNP of US $11,400 in 1981; it is one of seven major Western countries that meets in an annual economic summit.[19] Mexico, which is variously termed an "advanced developing country" and a "newly industrializing country", had a per capita GNP of only US $2,250 in 1981. Although Mexico's population is almost three times larger than Canada's, the Mexican Gross Domestic Product is considerably less than the Canadian figure. Political as well as economic differences are striking. Mexico is often regarded as having a rather authoritarian, one-party political system; of the three North American states its federalism is the most centralized, while Canada's is the most decentralized.

Canadian perceptions of distinctiveness are also strengthened by fears of organizational ties in the Western hemisphere that would force it to choose between either greater friction or closer alignment with the United States. It is generally accepted, for example, that Canada's non-membership in the Organization of American States permitted it to pursue independent policies towards Cuba without provoking a major conflict with its neighbour. In the North American setting: "There is no advantage in Canada siding firmly with

Mexico. . .in its differences with the United States if this position is to the detriment of the vital US-Canada relationship."[20] US statements in recent years favouring a common energy policy with Canada and Mexico merely strengthened Canada's fear of a tripartite "continentalism".

In view of the above-mentioned perceptions, it is not surprising that comparative analyses in Canada of US relations with its two closest neighbours have been rather sporadic and limited to a small number of issues and events. A non-trade area that has received some attention by Canadian scholars is foreign investment. Approximately 75 per cent of all foreign direct investment in Canada is of US origin. Although foreign direct investment faces substantially greater restrictions in Mexico, the United States accounts for about 70 per cent of the total. US investment in both countries tends to gravitate towards the most dynamic and profitable sectors. In 1973, Mexico instituted a major foreign investment law formalizing earlier requirements and broadening restrictions to new areas. Canada enacted its (considerably weaker) FIRA in the same year to ensure that new investment would have a positive effect on the country. While FIRA was in the planning stages, two Carleton University professors authored a study entitled Foreign Investment in Mexico: Some Lessons for Canada. However, there is no public evidence that Mexican models were used in development of the Agency.[21] Foreign investment comparisons continue to be of some interest; for example, the 1983 International Studies Association convention included a paper by a Sherbrooke University professor entitled Foreign Investment in Mexico and Canada: One Phenomenon--Two Different Approaches.[22]

Regarding foreign trade, attitudes of the Trudeau government concerning a trilateral focus were expressed primarily in response to US initiatives in this area. The 1974 US Trade Act permitted the President to "initiate negotiations for a trade agreement with Canada to establish a free trade area." This position was reiterated in the 1979 Trade Agreements Act, but the usefulness of agreements with Mexico, Central America and the Caribbean was also mentioned:

> [t]he President shall study the desirability of entering into trade agreements with countries in the northern part of the western hemisphere to promote the economic growth of the United States and such countries and the mutual expansion of market opportunities and report. . .his findings and conclusions within 2 years after the date of enactment of this Act.[23]

Additional support for an agreement came from the National Governors Association which passed a conference resolution in February 1979 proposing discussions on a tripartite common market for Canada, Mexico and the United States. The idea also surfaced in the 1980 presidential campaign, with such aspirants as Ronald Reagan, Edward Kennedy, John Connally and Edmund G. Brown Jr., endorsing some type of "North American accord".

The seriousness of these US initiatives has been questioned for a variety of reasons. First, the presidential study requested by the 1979 US trade legislation was to be a public document which would obviously limit the importance of its recommendations. Second, the trade legislation, the National Governors Association and the presidential candidates were all remarkably unspecific in discussing the form that a tripartite North American agreement would take. Such terms as a "common market", an "accord" and a "free-trade area" were often used loosely and interchangeably. Finally, there are numerous reasons to believe that a regional accord would conflict with the universalist principles of a major power such as the United States, and that labour unions and some other major US interests would express strong opposition.[24]

US interest in trilateralism stemmed less from a genuine desire to establish a broad-ranging accord than from a growing concern that a secure supply of energy and other resources could be garnered. Mexican policy-makers and intellectuals, in particular, pointed out that the "common market" idea gained prominence only in the 1970s, after the seriousness of the US energy crisis and the importance of Mexico's new hydrocarbon reserves were becoming increasingly apparent.[25]

Understandably, Prime Minister Pierre Trudeau and President López Portillo issued a joint statement in May 1980 strongly rejecting the trilateral concept. They felt that "such an approach would not serve the interest of their countries". Canada and Mexico were in agreement that their relationships with the United States should be conducted independently. In a speech to the Canadian Parliament, President Portillo stated that "proposals for a trilateral accord are incompatible with the objectives of Mexico's social and economic development, in view of the great difference between the development levels of the three countries."[26]

More specifically, Mexico has felt that petroleum is its most potent economic weapon, and that it can be used more effectively in bilateral rather than in multilateral arrangements. This was a major reason for Mexican opposition to both a North American accord and to membership in the General Agreement on Tariffs and Trade.

Even Canadian advocates of free trade with the United States, such as the Standing Senate Committee on Foreign Affairs, have been reluctant to endorse a trilateral free trade area:

> The Committee concludes that the free trade agreement should be drawn up initially only between Canada and the United States, but that it could be couched in North American terms so that if and when Mexico is ready to offer comparable access conditions, it could become part of the North American free trade area.[27]

Regarding relations between Canada and Mexico, the views of Prime Minister Trudeau seemed to parallel those of John Holmes "There are arguments for strengthening mutually beneficial links between Canada and Mexico, but not for entwining these in the serious and quite different problems between the United States and Mexico."[28]

Accordingly, the Trudeau and Portillo governments developed policies to upgrade Canadian-Mexican bilateral relations. In 1978 for example, President Portillo responded to Canadian initiatives by selecting Canada as one of five "designated priority countries" (along with Brazil, Japan, Spain and Sweden) for promoting economic linkages. As for Canada, it developed an export strategy for the 1980s emphasizing selectivity of market concentration; the first Export Development Plan published in accordance with this strategy was focused on Mexico.[29]

Canada should, of course, adopt its own distinctive approach towards both the United States and Mexico. However, Canadian (and Mexican) apprehension concerning such poorly-conceived concepts as a "North American common market" or a "continental energy policy" should not obscure the value to be obtained from adopting a broader "North American" perspective. The fact remains that the most crucial issue which Canada and Mexico have in common is the United States, and comparative studies of their trade and other economic relations can be of considerable value in policy-making. Whether bilateral, trilateral or multilateral approaches are eventually adopted, more systematic in-depth analysis of Canada's North American relations in a trilateral context is required. Canadian relations with both the United States and Mexico will not approach their potential as long as Canada continues to perceive "North America" only through a bipartite lens. It was earlier stated that Canadians generally exclude Mexicans from their concept of "North America". As for Mexicans, their term "norteamericano" refers exclusively to US citizens. The United States alone normally uses the term as referring to all three countries. Certainly US government policies towards Canada are differentiated from those towards Mexico; thus a proposal that Canada and Mexico be grouped in a new bureau of North American affairs in the US State Department has never been accepted. Nevertheless, close US ties with both Canada and Mexico permit US negotiators to adopt a more comprehensive vision of North America with all of the advantages this implies--an example is US negotiations for natural gas imports from its two neighbours. A statement by Christopher Tugendhat in his book The Multinationals, points to the disadvantage of delimiting one's perceptions as Canada (and Mexico) have done. Tugendhat notes that US companies were earlier able to "think big about Europe in a way that Europeans have found impossible. This, in turn, has enabled them to see and take advantage of opportunities that

European companies either failed to see, or were afraid to go for."[30]

A broader perception of North America would be advantageous to Canada in achieving foreign policy objectives with Mexico as well as with the United States. A trilateral focus would be helpful in more clearly identifying possibilities for co-operation and information exchange between the two smaller countries. Despite the moves to upgrade Canada-Mexican linkages, their relations continue to be sporadic and underdeveloped, even in areas of mutual concern. A 1981 symposium on energy policies at Harvard University reported that:

> Observers. .were surprised by the apparent absence of serious potential exchange between Canada and Mexico in the area of research and development. It had been thought the most promising area of cooperation. . .[but reference was not made] to such possibilities.[31]

The section that follows examines how Canada might benefit from a broader image of its "North American" trade relations and from a comparison with Mexican experience.

Trade Linkages With the United States

As a more developed state, Canada has numerous advantages over Mexico in foreign trade--both globally and vis-à-vis the United States. The two countries also have widely divergent policies in a variety of areas, such as membership in GATT. Nevertheless, both Canada and Mexico are extremely dependent on their common neighbour as a trading partner and in both cases, the trading relationship tends to be highly asymmetrical. Mexico and Canada therefore have a shared interest in decreasing their vulnerability to US trade policies on the one hand, and in encouraging US policies that are sensitive to their concerns on the other.

Differences Between Canada and Mexico as Trading Nations

Canada's role as a major trading nation is considerably more important than that of Mexico. Canada ranked ninth in the world for value of merchandise exports in 1981 while Mexico was 25; for imports, Canada was eighth while Mexico ranked 18th. (The United States ranked first for both exports and imports.)[32] With an internal market of only 24 million people, Canada's economy has been highly trade-oriented, and it was a founding member of GATT. In earlier years, Mexico followed import substitution policies, but a variety of problems, including widespread unemployment and a burgeoning foreign debt, caused a shift in emphasis in the 1970s to export growth and import liberalization. After a period of internal conflict over trade policies, Mexico decided against joining GATT, and a number of import restrictions have been reinstituted.

Canada's more positive view concerning trade liberalization also applies to its relationship with the United States. The subject of free trade with the US is now discussed "in polite society" in Canada, but not in Mexico. Free trade advocacy has been legitimized by favourable studies of the Economic Council of Canada, the Canadian Senate Committee on Foreign Affairs and the C.D. Howe Research Institute, as well as by statements of various government officials and academics.[33] Although free trade with the United States is not considered a serious option in Mexico, Professor Sidney Weintraub of the University of Texas has written several studies concerning the possible beneficial effects of free trade on the Mexican economy.[34]

The divergent policies of Canada and Mexico relate to their comparative development levels and trade balances. Almost every year since World War Two, Canada has had moderate to large surpluses in its overall trade. From 1968 to 1981, Canada had a trade deficit with the United States in 11 years, and a surplus in 11 years. The Canadian position vis-à-vis its southern neighbour was stronger from 1968 to 1981, however, with a deficit in only three years.[35]

Mexico, in marked contrast, had a substantial trade deficit (overall and with the United States) for every year from 1970 to 1981. The country's deficit with the United States declined rapidly after the 1976 peso devaluation, but it began to rise sharply again in 1979. In 1981, Mexico's deficit with its neighbour was a staggering $5.7 billion and its overall deficit almost $3.2 billion. Successive devaluations and the debt crisis subsequently contributed to an improved trade balance, but it is likely that (even with petroleum exports) large Mexican deficits will recur in the future.[36] Canada's stronger trade position stems partially from an industrial plant that is more developed than Mexico's, and more export-oriented. In 1979, "machinery, transport equipment, and other manufactures" accounted for 50 per cent of Canadian and 36 per cent of Mexican merchandise exports.[37]

Similarities in Trade Concerns

Despite the striking differences between Canada and Mexico, there are some similar concerns regarding trade. Tables 1 and 2 demonstrate that both countries conduct almost two-thirds of their trade with the United States. Japan, the second largest trading partner of both Mexico and Canada, accounts for a relatively low percentage.

Canada is the United States' largest trading partner and the value of goods traded exceeds that between any other two countries. Nevertheless, the relationship is highly asymmetrical; while the US market usually absorbs about two-thirds of Canadian exports, only about 16 per cent of US exports are normally directed to Canada. President Richard Nixon's mis-statement that Japan was the United States' largest trading partner could never have been made by a prime minister about Canadian trade. The asymmetry is considerably greater in the Mexican-US relationship, partly a reflection of the eight-to-one differential in productivity. By mid-1980, Mexico had outpaced Britain and West Germany to become the United States' third largest trading partner (Japan remains second), and Mexican petroleum is obviously of considerable interest to its northern neighbour. Nevertheless, in 1980 Mexico accounted for only 5 per cent of US imports and 6.9 per cent of its imports.

Although Canada clearly surpasses Mexico in industrial exports, both countries suffer from sizeable trade deficits in end products. At least half of the total exports of most industrial countries in 1980 were "finished manufactures" or "products not normally subject to a further manufacturing process"; this was true for such states as Japan, Italy, Federal Republic of Germany, Sweden, the United States, Britain and France. All of these countries also had positive trade balances in finished manufactures in 1980. Canada's position was markedly different, even though it is normally classified as "industrial". Finished manufactures accounted for only 32 per cent of its exports in 1980 and 59 per cent of its imports. If Canadian-US Auto Pact exchanges (which are largely intra-firm transfers of goods) are excluded, finished manufactures comprised only 22 per cent of Canadian exports for 1980. This compares with a figure of 23 per cent for India and 22 per cent for Brazil.[38]

Canada's commodity trade surplus in recent years has invariably contained two components--an extremely large surplus in crude and fabricated materials, almost balanced by a deficit in end products.[39] In 1981, for example, the Canadian trade surplus with other countries was Cdn. $2.3 billion, but for end products it had a deficit of $20 billion. Although Canada had a trade surplus of Cdn. $1.2 billion with the United States in 1981, its end product deficit with the US exceeded $15 billion.

Regarding Mexico, its efforts to increase manufactured exports have faltered in the face of inefficient production, an overvalued peso, increased dependence on petroleum sales and the global recession. While total Mexican exports increased almost 51 per cent during the first trimester of 1980, those from the manufacturing sector rose only 1.6 per cent.[40] Primary products (especially petroleum and its derivatives) currently account for over 75 per cent of Mexican exports to the United States, but for only about 20 per cent of imports from the United States.[41]

Canada and Mexico not only suffer from chronic end product trade deficits, but also from the nature of their manufactured exports. A large proportion of these are closely linked with US corporations, US agreements or special provisions in US law; thus, there is extreme dependence on US "good will". As a more developed country, Canada's linkages with the United States take such forms as the 1965 Automotive Agreement and the Defence Production Sharing Agreements. The Auto Pact is closely tied with the fortunes and actions of several major US corporations; a 1978 report of Canada's Senate Committee on Foreign Affairs noted that two-thirds of

Canadian end product exports to the United States were automotive products.[42] Canadian dependence on US corporations is certainly not limited to the automotive trade. Indeed, about 50 per cent of the country's manufactured exports to its southern neighbour are between a subsidiary and its parent.[43]

As a developing country, Mexico's special trade linkages are of a more "dependent" nature than in the Canadian case. Approximately two-thirds of Mexico's manufactured exports to the United States result from special provisions in US law. Of the $3.7 billion of manufactured products exported in 1979, $545 million came under the US generalized system of preference (GSP).[44] Initiated in January 1976, the GSP authorizes the President to grant duty-free treatment to certain eligible articles imported from designated less-developed countries (LDCs) for up to 10 years. Mexico has been a major beneficiary, but because of numerous restrictions on the GSP, it has more often exported manufactures under US tariff items 806.30 and 807.00. These permit US companies to use US-manufactured materials in foreign manufacturing and assembly plants, and to pay duties only on "value added" to the products when they are re-imported to the United States.[45]

Mexico and Canada are among the leading worldwide sources of imports under the two tariff items. But as an LDC, Mexico's input takes the form of lower wage, labour-intensive assembly operations. In 1978, Canada was the leading supplier of item 806.30 imports, principally aircraft parts and steel plates, sheets and strips. Canada was the fourth leading supplier of item 807.00 imports, primarily office machines and non-piston internal combustion engines. By 1970, Mexico had become the largest assembler of US-manufactured components for re-export across the border. Mexico was the second-ranked supplier of item 807.00 imports in 1978, including television apparatus and parts, circuit breakers and voltage regulators, motor vehicles and parts, and semiconductors. Mexico was the third largest supplier of 806.30 imports, principally semiconductors and parts of automobile wheels.[46]

Assembly operations in Mexico occur primarily in border industries termed "maquiladoras", begun in 1965. US companies can pay employees in "maquiladoras" lower wages than US rates; for example, the US hourly wage for workers assembling electronic components is 4.4 times higher than in Mexico. About 75 per cent of the "maquila" labour force is female. Plant managers maintain that women are more dexterous and psychologically suited for the detailed assembly work; however, a more likely reason is that women can be paid lower wages. In 1981, employees in Mexican "maquiladoras" numbered almost 131,000.[47]

Canada's and Mexico's special trade linkages are a reminder of the vulnerability of a large proportion of their manufactured exports. In recent years, the Auto Agreement has been strongly criticized in Canada for not benefiting the economy. The country was consistently in a deficit automotive trade position with the United States from 1973 to 1981. An auto trade surplus for Canada in 1982 resulted from renewed US demand for larger automobiles manufactured in Canadian plants, and from the fact that the US economy was less depressed than the Canadian. An economic upturn combined with a shift again to smaller automobiles could easily restore Canada's deficit position.

Long-term trends in the automotive trade certainly seem to operate against Canadian interests. Although the auto parts deficit fell in 1982, it still amounted to $4.8 billion and is likely to persist; in this area Canada is dependent on sourcing decisions of the US automakers. Furthermore, inadequate safeguards have resulted in almost total concentration of research and development by the "Big Four" automakers in the United States.[48] The Auto Pact is also threatened with obsolescence in view of the growing competition emanating from Japanese and European manufacturers.

Although the Auto Agreement in its present form has numerous disadvantages for Canada, a 1978 Report of the Senate Committee on Foreign Affairs opposed reopening of negotiations. The committee cautioned that:

> there is every risk that in a renegotiation, the United States would not agree to continued safeguards for the

> vehicle producers, let alone the parts producers. . . . Termination would be one of the possible US responses to a Canadian initiative to renegotiate. And if the agreement were terminated, many more problems would ensue for Canada than for the United States.[49]

As for Mexico, its manufactured exports are threatened by the US view of the generalized system of preferences as a temporary deviation from the trade regime norms of non-discrimination and efficiency.[50] A country exceeding the "competitive need ceiling", which is 50 per cent of total US imports of a product, or a certain dollar value ($37.3 million in 1979), is no longer eligible for GSP treatment. For example, in the late 1970s Mexico was a major supplier of railcars to the United States which entered duty free under the GSP. Since other countries exported fewer railcars to the United States in 1977, Mexico surpassed the 50 per cent total of US imports by supplying only 34 cars. Even though the United States required more railcars, an 18 per cent duty was imposed on each Mexican railcar sold, seriously hindering its exports.[51] Rigid enforcement of the GSP regulation has blocked a number of other Mexican exports in which its comparative advantage is greatest. Fifty Mexican export products were excluded from the US GSP in 1980, and 44 additional products were excluded starting from April 1981.[52] Mexican exports are further threatened by the fact that legislation will be required to extend the US GSP program beyond 3 January 1985, and at that time Congress might support reallocation of more benefits to the lower-income LDCs.

Mexicans are additionally cognizant of potential difficulties with maintaining the "maquiladoras". The AFL-CIO first introduced legislation to repeal the US tariff provisions in 1969 and has continued its opposition, maintaining that US jobs are being exported. Although the US Tariff Commission has refuted this contention, worker dissatisfaction has continued. Furthermore, there is a constant threat that assembly operations could be relocated; from 1972 to 1978, Mexico lost some of its market share to Colombia, the Dominican Republic and El Salvador. Mexico's proximity to the United States has given it great advantages in terms of transportation costs and existing infrastructure, and in growing at competitive costs; but other factors such as relatively high wages on the Mexican border are also a consideration.

> Once the decision is made to admit assembly operations, host governments either permit flexibility in dealing with problems that may arise or risk eventual abandonment of plants, reduction in employment, and loss of foreign exchange income. Reluctance by Mexico to remain competitive for offshore production sites, especially within the Caribbean region, could foster reassessment of the maquiladoras as in the mid-1970s.[53]

In summary, Mexico and Canada have both been frustrated by extreme trade dependence on the United States, and by chronic trade deficits in end products. Furthermore, a large proportion of their manufactured exports are vulnerable because of their linkage with bilateral agreements and special provisions in US law. The following discussion examines how a comparative analysis of Canadian and Mexican experiences can be helpful in the formulation of Canada's trade policy.

Comparative Analysis and Canadian Policy Directions

Diversification Experiences

Canada and Mexico have both periodically sought to diversify trading partners in order to decrease dependence on the United States. Although nationalist sentiments favouring independent action are clearly stronger in Mexico, critics of these policies sometimes use similar arguments--that diversification is not genuinely followed, but promoted primarily in government rhetoric; that significant diversification is not feasible; that diversification in the absence of structural changes will not remedy Canadian (or Mexican) problems; and that diversification can occur naturally but not be consciously promoted. In Canada, some policy-makers and academics also seem to question the desirability of such policies. A comparative analysis of Canadian and Mexican experiences would test the validity of these criticisms, and also examine the relative effectiveness of the two countries' diversification strategies.

Diversification for Canada has been closely linked with the search for a "counterweight", which is "almost as old as the existence of Canadian foreign policy with respect to the United States."[54] During the period when Canada was more dependent on Britain, the United States was considered a counterweight to British influence. Subsequently there was an attempt to counterbalance the two states and then Britain became the counterweight (at least in rhetoric) to US influence. As British power declined, Canada looked to the European Community (EEC) and Japan as counterweights.[55]

A study by Michael Dolan indicates that, under appropriate conditions, a greater sense of vulnerability to the United States increases Canada's desire to diversify relations.[56] The new economic policies of President Nixon in August 1971, the 10 per cent import surcharge and Canada's failure to gain an exemption contributed to the 1972 Options for the Future paper issued by the Department of External Affairs.[57] Three "Options" were examined in the paper, of which the first (that Canada should "maintain its present relationship" with the United States) and the second (that Canada should "move deliberately towards closer integration" with the United States) were rejected. The "Third Option", defined as "efforts to reduce the present Canadian vulnerability to American actions" was recommended. Vulnerability was to be reduced partly by upgrading relationships with other states, particularly the European Community and Japan. However, Options for the Future was never published as a white paper since some cabinet members considered the policy too controversial; and the first and second options were advocated in some circles.

Regular efforts have also been made by Mexico to diversify economic relationships and its efforts (like Canada's) increased in the 1970s. President Luis Echeverría took many visits abroad during the 1970-1976 period in search of new trading partners and promoted collaboration with other LDCs in seeking better treatment for the Third World. Echeverría maintained that the United States should expect no special treatment in oil deals and argued against increased sales to that country.[58] Although the Portillo government (1976-1982) was friendlier towards the United States, export diversification efforts continued. In November 1980, José Andrés Oteyza, the Minister of National Patrimony, stated that a 1.5 million barrel-per-day ceiling had been placed on petroleum exports and that no greater than 50 per cent could be sold to any one country. This decision was clearly aimed at the United States which had received 80 per cent to 85 per cent of Mexico's crude oil exports from 1974 to 1979. A similar ceiling seemed to limit natural gas exports to the 1980 level of 300 million cubic feet per day.

Available evidence indicates that both Mexico and Canada have found it easier to expound on diversification policies than to actually succeed in reducing their vulnerability in foreign trade. Tables 1 and 2 demonstrate that the marked disparity in trade with the United States vis-à-vis other countries persists into the 1980s. During the 1950s, the share of Canadian exports to the United States began to exceed 50 per cent, and the percentage has generally moved upward for the last 30 years.[59] Regarding Mexico, about 80 per cent of its trade was conducted with the United States in the 1940s and some diversification clearly occurred in subsequent decades. However, there was no clear-cut trend in the 1960s and early 1970s, and the proportion of trade with the United States began to increase when Portillo became President in 1976.

The current global recession, and its debilitating effects on Canada and Mexico, have created additional doubts about diversification policies. The "Third Option" had been introduced during a period of relative prosperity in Canada, and Mexico's intention to diversify petroleum exports was also announced when the atmosphere was relatively optimistic. Nevertheless, diversification policies are often perceived as "luxuries" that are not affordable during difficult periods. Mexico did temporarily fulfill its goal of decreasing the percentage of oil exports to the United States. With softening of the petroleum market, however, Mexico made a long-term commitment to sell the United States increased quantities, at preferential cost, for its strategic reserve. Mexico's dependence on US support for relief of its massive foreign debt crisis seriously weakens its ability to pursue a diversification strategy.

A Globe and Mail editorial in June 1982 indicated just how far Canadian thinking had moved in some circles from diversification:

> He [Finance Minister Allan MacEachen] knows that the foreign currency that matters to Canada is the United States dollar, that 70 per cent of our foreign trade is done with that country, and that the vast bulk of all our foreign trade is done in US dollars. He knows that Canada can reject that special US relationship only if it wants to become a poor Third World country.[60]

On 31 August 1983, Trade Minister Gerald Regan released a policy paper resulting from a year-long federal study of Canada's trade options. Although the idea of unlimited free trade with the United States is rejected, the study indicates that the Trudeau government will seek free-trade agreements in selected sectors with the United States; the Auto Pact would exemplify the type of sectoral arrangements to be concluded. The policy paper clearly moves Canada away from the Third Option as its conclusions attest "While Canada is not formally a member of a regional bloc, at a practical level we are to all intents and purposes part of a North American regional market and thus partner with a very significant player [the United States] indeed."[61]

Some analysts would maintain that diversification difficulties result not only from "the economic times", but also from linkages between trade and foreign investment. As discussed, the United States is by far the largest foreign investor in both Canada and Mexico. Claims have been made that Canadian and Mexican exports to third countries are necessarily delimited because US multinationals restrict the trade patterns of their subsidiaries, and because a considerable amount of trade involves intra-company transfers. Certain analysts, however, dispute these assertions and further research is necessary.

Despite the difficulties in implementing diversification, there are indications that it could be one in an array of effective policies pursued by Canada and Mexico if there were some changes in focus. Tables 1 and 2 demonstrate that the major trading partners of both countries tend to be industrialized states. Only four LDCs are listed among Canada's major importers and exporters, and two of these (Saudi Arabia and Venezuela) result from the special case of petroleum exports; as for Mexico, only two LDCs are listed (Brazil and Netherlands Antilles). Despite its location, Mexico sends only about 2 per cent of its exports to Central America and the Caribbean and only 4 per cent to the rest of Latin America.[62] Diversification policies of both Mexico and Canada have tended to perpetuate this emphasis on more developed states. Canada's Third Option contributed to special efforts to solidify linkages with the European Community and Japan. Among the five "designated priority" countries of Portillo, later expanded to six with the inclusion of France, only Brazil is a developing country. (The others are Canada, Japan, Spain and Sweden.)

Canada and Mexico would benefit from greater diversification efforts vis-à-vis LDCs. Although both countries have strengthened ties with Japan and Western Europe, they continue to experience difficulties in substantially increasing exports (particularly of industrial goods) to these areas. Canada's Third Option, for example, eventually contributed to the signing of contractual link agreements with the European Community in July 1976 and with Japan in October of that year. Although these agreements have facilitated consultation, they are non-preferential and there is no indication that they have significantly reoriented Canadian trade. In fact, with the global recession the EC's share of total Canadian exports declined to 9.1 per cent in 1982 from 10.8 per cent in 1981 and a peak of 14.5 per cent a decade earlier. A Globe and Mail article opined: "The slump has effectively erased gains in trade between Canada and Europe made during much of the 1970s."[63] Regarding Mexico, its agreements with industrial states based on its petroleum exports have been vulnerable in the face of the global recession and the soft oil market. A statement by A. Gotlieb and J. Kinsman on reviving Canada's Third Option could (to a lesser extent) also be applied to Mexico: "Exciting prospects emerge from the growing importance of the newly-industrialized countries. . . . Along with the US itself, these are now the high-growth markets for our capital goods."[64]

Although greater attention should be given to LDCs, Canada and Mexico will realistically continue to focus most of their diversification efforts towards industrial states. Examination of Mexico's agreements linking petroleum exports with industrial co-operation and technology transfers (with Japan, Canada, Sweden, Spain and France) would be helpful to Canada in striking agreements involving its own natural resources. In a world where many resources are being rapidly depleted, such arrangements might become an increasingly important foreign policy tool.

Experiences With "The New Protectionism"

Even if Canada and Mexico diversify their trading partners, the predominant share of their trade will continue to be focused on the United States. The role of protectionism in the Canadian-US relationship is much different in certain respects than in the Mexican-US case, largely because of Mexico's developing-country status and its non-adherence to GATT. Since Mexico is a non-signatory of the Tokyo Round Codes for example, US countervailing duties are presenting more frequent difficulties for Mexicans than for Canadians. Nevertheless, a recent study by Gustavo Vega Canovas concludes that current problems confronting Mexican exports to the United States are more attributable to the rise of "neo-protectionism" than to Mexico's refusal to join GATT.[65] The "new protectionism" presents both Mexico and Canada with critical difficulties in relations with their largest trading partner. A comparative analysis of the two countries' efforts to confront this challenge would be useful in development of Canada's policies in this area.

Melvyn Krauss describes the "new protectionism" as referring to:

> how the totality of government intervention into the private economy affects international trade. The emphasis on trade is still there - hence the term 'protection'. But what is new is the realization that virtually all government activity can affect international economic relations.[66]

Neo-protectionist measures include non-tariff barriers utilized increasingly in place of tariffs that have been reduced in successive GATT negotiations. Export-oriented non-tariff barriers involve a variety of incentives and subsidies to promote exports and protect the domestic market; "contingency-protection" or defensive measures consist of anti-dumping and countervailing duties, GATT escape clause provisions, and measures to confront unfair trade practices.

With the relative decline of US predominance as a trading nation, and its balance-of-trade deficits beginning in 1971, the United States has resorted to more aggressive use of protectionist practices. It is erroneous to imply that the United States is necessarily the worst offender in this area since the European Community and Japan have erected some formidable barriers of their own; nevertheless, Mexican and Canadian trade patterns make them particularly vulnerable to the US measures. As discussed, certain US actions such as the Nixon 10 per cent surcharge have been aimed primarily at the most serious protagonists--the EEC and Japan--but Canada and Mexico are often the countries most threatened by such policies.

Inadequacy of the Multilateral Route

Experience demonstrates that the multilateral GATT route (although important for Canada) is inadequate in handling many problems related to neo-protectionism. Mexico's decision against joining GATT and against associating itself with the Tokyo Round Codes was coupled with the view that its objectives could be better achieved by bilateral arrangements. In a March 1980 speech, the Secretary of Resources and Industrial Development expressed the concern that GATT would restrict Mexico's use of its petroleum reserves. Petroleum was considered to be the country's strongest economic weapon, and the feeling existed that it could only be used effectively in bilateral negotiations with the United States and other countries. The possibility has also surfaced of bilateral sectoral agreements with the United States, although numerous obstacles remain. Potential areas for special arrangements include agriculture, automobiles, railcars and petroleum products. Some of the analyses written since Mexico decided not to join GATT have explored the various options available to the country for bilateral negotiations with the United States and others. If bilateral agreements are not concluded, US trade laws referring to subsidies and countervailing duties could be extremely detrimental to Mexico.[67]

Although Canada helped in planning the postwar GATT system, it will also seek bilateral solutions to many of its trade conflicts. John Holmes has written that Canada often feels like an outsider in multilateral fora because "the US forgets about us. It makes arrangements in GATT with the European Community or Japan in mind which bear harshly on Canada."[68]

The recent Tokyo Round agreements reflect the tendency of the "big three" to impose their agreed compromises on other participants. An example is the "sectoral approach", favoured by the Canadian delegation which would permit countries to upgrade their resources without being confronted with excessive tariffs. The international bias in favour of importing raw materials makes it difficult for resource-rich states like Canada to establish resource-based manufacturing industries. A sectors group was established at the Tokyo Round meetings and Canada proposed that its negotiations begin with such non-ferrous metals as copper, nickel, lead and zinc. The United States was mildly supportive of the Canadian initiative for some products, but was not sufficiently interested to contend with European opposition and the subject was eventually dropped.[69] This exemplifies an issue that might produce results on a bilateral basis with the United States but which was basically a non-starter multilaterally.

As regards neo-protectionism, the Canadian Senate Committee on Foreign Affairs (adopting many of the views of Rodney Grey, Canada's chief negotiator in the Tokyo Round) was:

> convinced that the only way to deal with. . .procurement, countervail, customs valuations, DISC, and safeguard restrictions is through bilateral negotiations with the United States. The only way to get inside the new, potentially protectionist US trade regulatory system is through a bilateral arrangement with the United States.[70]

These non-tariff barriers, which are difficult to deal with on a multilateral basis, are assuming relatively greater importance in the protectionism of many countries--and the United States is no exception. The efficacy of multilateralism has also been adversely affected in recent years by the grouping of countries into trading blocs. Bilateral rather than multilateral arrangements will therefore be more important for both Canada and Mexico in neo-protectionist disputes with their common neighbour.

Familiarity with Domestic US Politics

Canadian and Mexican frustrations with US neo-protectionism indicate how essential it is to have an intimate knowledge of US politics. For example, the two countries' policies have been less effective because of inadequate approaches to the US Congress, and they could benefit from each other's experience.

US dichotomous behaviour in foreign trade has sometimes reflected a struggle between the White House, representing transnational sectors interested in a more open economy, and the Congress, reflecting protectionist regional and local interests. It would be a gross over-simplification to characterize the Congress as uniformly protectionist. The votes of Democrats (especially non-Southerners) have tended to parallel labour-group sympathies, favouring legislation to decrease tariffs in 1962, but opposing such legislation in 1970 and 1974. In contrast, some congressional Republicans responsive to major business organizations have become more positive to trade liberalization, partly reflecting the emergence of large multinational corporations that benefit from freer trade.

Despite these conflicting tendencies, there are numerous examples of congressional efforts to exert protectionist pressures on the President. "Buy American" provisions have been passed by legislatures at both federal and state levels over objections of their executive branches; Congress approved the Auto Pact with Canada in 1964, but has been unwilling to approve a modification of its terms; and Congress inserted new arrangements regarding unfair trade (i.e., the "new protectionism") in the 1974 US Trade Law and the 1979 Trade

Agreements Law in exchange for authorizing the White House to negotiate tariff decreases in GATT multilateral trade negotiations.

Recent changes in the role and functioning of Congress are also conducive to protectionism. The seniority system has become less important, and with it the dominant position of some committees and their chairmen. As a result, party discipline has declined giving greater independence to individual congressmen and providing more opportunity for lobbying. Another favourable change for domestic lobbies has been the more significant role of the House of Representatives in US foreign policy decisions. Under the Constitution, the President is to conduct foreign affairs acting with the advice and consent of the Senate. However, domestic economic measures which are a House responsibility, are having a growing impact on foreign businesses; these are the issues that frequently concern Canada and Mexico. The two-year term of House members (as opposed to the six-year Senate term) increases their sensitivity to domestic lobbies with protectionist views that often conflict with Canadian and Mexican interests.

Mexico and Canada have both been insufficiently attuned to the changing functions and roles of the US Congress. A member of the House of Representatives Foreign Relations Committee recently stated, "The Canadian embassy in Washington is good in dealing with the State department, but it is not good with Congress" and a partner in a Washington law firm that represents a number of Canadian clients maintained that Canada does not do "the political side of trade as well as it does the legal side."[71] Mexico's failure to work with Congress "diligently or effectively" has been explained by several factors:

> the opportunities afforded by the Inter-parliamentary meetings, the personalistic style of diplomacy, reliance on and familiarity with the Department of State, a belief that Congressional politics are not subject to influence by foreign governments, perhaps even an assumption that policy-making in the United States is not unlike policy-making in Mexico and that, consequently, the legislature is not worthy of serious attention. It also is possible that the Mexicans simply have not known how to deal with Congress.[72]

A number of similarities exist in Mexican and Canadian problems with the US legislative branch; for example, both countries have experienced difficulties with the separation-of-powers concept. In the Mexican system, the President's position is extremely powerful, and the Congress passes almost all laws that he proposes without major modifications. Mexico sometimes has understandably been ill-prepared to contend with the influential Congress in the US government. Canada's problems with the separation-of-powers concept have been described by Peter Dobell, Director of the Parliamentary Centre for Foreign Affairs and Foreign Trade:

> [W]ith parliamentary government. . .the prime minister and the government are in practice normally able to speak for and commit Parliament. That the separation of powers produces an entirely different situation in Washington is a fact often ignored in Canada.[73]

Efforts are underway in both Canada and Mexico to develop expertise and refine techniques. In the Mexican case, the journal Foro Internacional has published translations of congressional documents, the Centro de Investigacion y Docencia Económicas (CIDE) issues numerous publications on the US system of government (including the Congress),[74] and former President Portillo sent a special advisor to Washington to encourage congressional contracts in January 1979. In Canada's case, the Cabinet has approved a policy developed by the Department of External Affairs to ensure that Canadian views on crucial bilateral issues are more clearly heard in the United States, with Congress one of the intended targets.[75] Canada and Mexico are both acutely aware that any increased lobbying activity in Washington requires caution and diplomacy, and a comparative study of their experiences would be useful.

Similar to the Congress, certain US companies and business groups have acted as decentralized forces of protectionism in conflict with the executive branch. Other private sector actors, however, have favored a more liberal trading system. Canada and Mexico could learn from each other's experience in forming coalitions with private actors in the United States that support their positions.

The US government has regularly been encouraged by some protectionist-oriented groups to impose contingency protection measures including countervailing duties and anti-dumping measures. These present a particularly acute problem for Mexico since Tokyo Round Codes regulating the use of such duties need not apply to non-signatories--that is, US behaviour towards Mexico is less subject to international regulation than towards Canada. Nevertheless, US legislation presents potentially serious obstacles to Canadian as well as Mexican exports, and the Tokyo Round Codes are in many respects inadequate remedies.

"Countervailing duties" are "imposed by one country to offset the lower price of an imported good, production of which has been subsidized (or otherwise supported) by the producer's government". GATT Article 6 requires evidence that the subsidized imports have caused material injury to domestic producers before such duties are levied. Previous to the Tokyo Round, the United States government could (under a US law predating GATT) countervail against imports even without evidence of injury; it was only necessary to establish that the exporting country had provided a bounty or grant. The United States eventually agreed to the injury test, but the threat of protectionism towards Code signatories such as Canada is not necessarily alleviated for several reasons. The US adopted a very weak and ambiguous definition of "material injury", and the 1979 US Trade Act was amended to make it easier for US companies to lodge complaints and for the International Trade Commission to find injury. Furthermore, the Trade Act established mandatory "fast-track" mechanisms to facilitate decisions that injury has occurred; and the Secretary of Commerce lost the authority that the Treasury Secretary previously had to waive countervailing duties. Concerning "anti-dumping" measures ("dumping" occurs when a product is sold at a lower price for export than it is in the domestic market), the Tokyo Round Code has actually been viewed as a retrogressive step, since the 1967 Code had contained a stronger injury requirement.[76]

A recent example where the US private sector utilized its increased prerogatives to lodge complaints concerned Canadian lumber exports. In the summer of 1981, certain US producers of lumber and softwood products claimed that Canada's industry was subsidized and that Canadian exports had materially injured the US industry. The US International Trade Commission responded in November 1982, deciding that the Commerce Department's International Trade Administration should review Canadian exports of lumber, shakes and shingles, and fencing materials; if it determined that there were subsidies causing material injury, a countervailing duty could be imposed. On 8 March 1983, the department's preliminary findings were that countervail should not be instituted, and this was confirmed by a final determination on 23 May 1983. The Commerce Department found that subsidies to Canadian lumber companies averaged less than 0.5 per cent.

Even though Canada "won" this case, the final decision was taken almost two years after the initial complaint. The lengthy period of uncertainty had a detrimental effect on the Canadian lumber industry and economy, and the issue provided a stark reminder of Canada's vulnerability to US protectionism. Softwood lumber is the country's most important export to the United States after automobiles, and British Columbia's sawmill industry exists primarily to make lumber for the United States, which traditionally buys 60 per cent to 70 per cent of its production.

Transnational linkages with private US groups opposed to protectionism were extremely important to Canada in the lumber dispute. The coalition that petitioned in favour of countervailing duties represented nine trade associations and greater than 650 companies in the United States, and did not join in the petition. Also, the National Association of Home Builders, realtors and wholesale lumber dealers argued against imposition of countervail.[77]

Canada and Mexico could learn from each other's experience in coalition-formation with US private groups (such as those mentioned above in regard to Canada) that support their interests. Mexico has had similar experiences in which US private interests have opposed protectionist forces in the United States, creating opportunities for cross-national linkages. A prime example is the case of Mexican exports of winter vegetables that are as crucial to Mexico as lumber exports are to Canada. Indeed, after oil, they are the most valuable Mexican export to the United States.[78]

Florida vegetable producers have strongly opposed Mexico's participation in the US market since the 1930s. An attempt to erect non-tariff barriers through Department of Agriculture regulations led to the first "Tomato War" in 1969. The second "Tomato War" resulted when US producers on 12 September 1978 filed a petition with the Treasury Department claiming that Mexico had violated the US Anti-Dumping Act by exporting five vegetables at "below cost". The final determination of the Commerce Department (which replaced Treasury as the administering authority under the 1979 Trade Act) was published on 28 March 1980; it was decided that Mexican produce was not being exported at less than fair value and that anti-dumping duties should not be imposed. However, as in the Canadian-US lumber case, the conflict itself has had a detrimental effect on Mexico's winter vegetable industry. Tomato exports declined from $206 million in 1979 to $185 million in 1980. Also, the Mexican Growers Association has adopted a plan (that is not always enforced) of self-regulated export controls based on size and quality, and some Mexican growers are switching to crops other than winter vegetables. Furthermore, Florida growers are pursuing other avenues of litigation in their efforts to restrict imports.[79]

The "Tomato War" of 1978-80 has been described as "a conflict between coalitions extending across national boundaries. It pitted Florida tomato growers against an international coalition of Mexican producers in Sinaloa and Sonora and US distributors in Arizona and elsewhere in the Southwest."[80]

Mexican producer-distributors and Arizona distributors have also identified the US consumer as a potential ally and have successfully organized campaigns to involve consumer groups in the support of tomato imports. Consumers stand to benefit from lower prices

(Florida cannot supply the entire market at reasonable costs), and from the better nutrition and taste provided by vine-ripened Mexican tomatoes.

In summary, this discussion of the Mexican-US "Tomato-Wars" and the Canadian-US lumber dispute is designed to illustrate that comparative studies of the role of transnational coalitions in trade disputes could be helpful to Canada in contending with "the new protectionism". More detailed analyses of these and other trade conflicts are of course required.

Experiences With The Principle of "Unequal Treatment"

At a February 1979 meeting between the presidents of the United States and Mexico, a Mexican view was expressed that LDCs should be given special treatment under "just terms that are equal for equals and unequal for unequals". Although Canada's position is considerably "less unequal" than that of Mexico, the two countries have a vital stake in acceptance of this principle. Awareness of each country's efforts to legitimize "unequal treatment" would be mutually beneficial. Whether one speaks of US neo-protectionism, of possible "free trade" with the United States, or of Mexican and Canadian measures to promote (regional or national) development, agreement on this principle is crucial to harmonious North American relations.

In response to the relative decline in its economic power, the United States has engaged in dichotomous behaviour in foreign trade. As discussed, the country has strongly contributed to a growing trend towards the new protectionism. However, greater commitment has also been expressed to a free-trade ideology, blaming narrow nationalism and protectionism of other countries for US economic problems.[81] The free-trade protectionist dichotomy was evident in January 1983 when President Reagan maintained in his State of the Union address that his government was "an unrelenting advocate of free trade;" at the same time members of the 98th Congress were pressuring for tougher policy towards foreign commercial competitors.

The ideological commitment of the White House to an open trading system has often compounded the difficulties Mexico and Canada have experienced in promoting industrial exports. Policies that the United States has viewed as protectionist or "unfair trade practices" have often been perceived by its two neighbours as essential to promoting industrial development. From the Mexican and Canadian perspectives, US advocacy of an open economy has not been sufficiently sensitive to their need for "unequal treatment".

US pressures on Mexico to join GATT and to graduate from the generalized system of preferences are (in the Mexican view) indications of US unwillingness to accept its special requirements. To understand the basis of the two countries' conflicting philosophies on GATT, some background to the Mexican decision is essential.[82]

By the 1950s, Mexico had developed well-established import substitution policies, similar to many other LDCs (particularly in Latin America). The government had instituted a rigid licensing regime, extremely high tariffs, protective effect of which was increased by an official price valuation system, and low quotas on selected products. However, the sheltered industries concentrated on producing consumer goods, and Mexico in fact became more dependent on imported capital and intermediate goods; consequently the current account deficit increased.

Policy began to change in late 1976 about the time Mexico had its worst financial crisis since World War Two and was forced to seek assistance from the International Monetary Fund. At the time that import liberalization began, about 85 per cent of all products required import permits. However, trade strategy gradually became less inward-looking, shifting to a combination of export promotion and selective import substitution concentrating on capital and intermediate goods. In view of this trend towards trade liberalization, the US government was extremely hopeful when the Mexican government informed the GATT director-general in January 1979 that it wanted to begin negotiations for its accession to the Agreement. The Protocol Plan for Mexico to join GATT was subsequently written and President Portillo made the unusual decision to submit it to the populace for debate and consultation in November 1979. Optimism of some US officials that Mexico would favor accession seemed to underestimate the effect of the country's ongoing nationalist/internationalist debate on trade policy:

> Competing ideologies (not just interests as in the US) co-exist within each Mexican administration: one advocates relatively free trade and increased integration of the economy into the global economic system; the other emphasizes autonomous national development, an increased role for the state and protection into the foreseeable future [albeit 'rationalized' protection]. . .we can expect a constant and unresolved struggle over the next decade within Mexico about, among other things, the issue of free trade.[83]

Donald Story has classified supporters of Mexican accession to GATT into two major groups--those within the government favouring a more liberal trading system, and members of large business enterprises who would not feel intimidated by an increase in foreign competition. However, Story notes that the interests opposed to Mexican adherence were more numerous, influential and vocal. They consisted of intellectuals with nationalist leanings, government planners and private sector protectionists. Some of the reasons for their opposition included the following:

- The US preference for free trade through encouraging global specialization has contributed to Mexico's continued dependence on the sale of raw materials.
- GATT membership would interfere with Mexico's new export strategy by restricting the use of subsidies, export performance requirements and local content requirements.
- Strong US support for Mexican membership (even though heavy-handed methods were not used) raises questions about their motives; and a decision to join would be interpreted as Mexican compliance with US demands.

The arguments against membership eventually prevailed and Mexico announced its decision to postpone joining GATT on 18 March 1980. Previously, Mexico's non-membership had not presented serious problems because it had secured most-favoured-nation treatment informally from the United States. Nevertheless, Washington's reaction to the decision was hostile and there were indications of possible retaliation. Furthermore, US trade legislation was soon to present major problems for Mexico; for example, the material injury requirement for imposing US countervailing duties is not applicable to non-signatories of the Tokyo Round Code.

Many Mexicans have interpreted the US reaction as insensitive to their need for "unequal treatment". Although a number of LDCs are now contracting parties in GATT, the great majority of them were dissatisfied with the outcome of the Tokyo Round of multilateral trade negotiations (MTN). Indeed, almost all LDCs boycotted the signing of the MTN agreement on 12 April 1979. They were particularly disappointed in that the MTN failed to institute a new "safeguards" code permitting Third World countries to protect industries threatened by imports, that the negotiated tariff reductions were more beneficial to the industrial states, and that the graduation principle had been included (at US behest) in the agreements. Although the United States in theory is treating all non-signatories of the GATT codes in a similar fashion, in fact its actions can be viewed as discriminating against LDCs (i.e., these are the main group of non-signatories).

As a more developed state, Canada's concerns are in many respects very different from those of Mexico. Nevertheless, Canada would encourage acceptance of the "unequal treatment" principle in regard to less-developed regions of the country and to areas (such as technology and R&D) where its development is markedly "incomplete". Regarding regional development, the grants and other incentives offered by the Department of Regional Economic Expansion inducing Michelin to establish tire plants in Nova Scotia are relevant. Economic viability of the project depended on the ability to export over 80 per cent of production to the United States, but US producers requested that the Treasury Department impose countervailing duties. The Treasury Department had earlier developed a practice of "offsetting" in determining countervail--only an amount greater than the difference between establishing a plant in a prime location versus a less favourable site would be considered a subsidy. Regional development grants had therefore been accepted as legitimate national policies. Offsetting was not used, however, in the Michelin case, and the United States imposed a countervailing duty in 1973. At that time, it was unnecessary to demonstrate injury to a US industry, and the Treasury Department merely determined that Michelin was receiving "bounties or grants" from the Canadian and Nova Scotian governments. Although the countervailing duty was later reduced, the initial damage effectively restricted future development of the Michelin enterprise. Other companies that subsequently received regional development aid in Canada have not been the target of US countervail, but the Michelin case did establish a precedent and could be repeated.

In February 1979, the US Treasury Department also imposed a countervailing duty on imports of a Honeywell optical sensing system produced in Canada because federal government assistance for research and development was considered a bounty or grant under Section 303 of the Tariff Act. The grant of about Cdn. $361,000 to develop a means of preventing overfilling of distribution tanks and oil tank vehicles was provided under the Program for the Advancement of Industrial Technology. A US company argued that the grant created unfair competition but, from a Canadian perspective, the countervail decision created concern about US barriers to development of a high technology, export-oriented industry in Canada.[84]

Regarding sectoral "free trade", various safeguards were provided to Canada when the 1965 Auto Pact was signed in recognition of its economic disadvantages vis-à-vis the United States. However, these safeguards eventually led to head-on conflict between the two countries, and serious philosophical differences emerged concerning the nature of free trade between unequal partners.

Most of the safeguards were designed to ensure that Canadian production of automotive products would be maintained at a base level or above. In letters of commitment exchanged when the Auto Pact was signed, the manufacturers agreed that the increase in Canadian value added would amount to no less than 60 per cent of the increase in value of automobiles sold in Canada (the figure was 50 per cent for commerical vehicles), and that the amount of Canadian value added, beginning in August 1967, would increase by a further $260 million annually. Additional safeguards for Canada were provided within the Auto Pact itself.

Some of the safeguards were met fairly rapidly but others have been the subject of major controversy. During automatic review of the Auto Pact in 1968, Canada argued that the safeguards were essential while the United States countered that they were temporary and that a termination date should be established. The US position hardened since its automotive trade surplus with Canada had declined from $658 million in 1965 to $360 million in 1968, and became a deficit of $197 million in 1972. In the latter year, US Treasury Secretary John Connally described the safeguards as the "principal irritant" in Canadian-US relations.[85]

From a Canadian perspective, the first article of the Auto Pact which refers to participation of both countries on "a fair and equitable basis" has particular importance. This is interpreted as ensuring Canada a "fair" proportion of investment, production, research and employment in the industry. As discussed, Canada has been increasingly dissatisfied in certain areas such as its share of research and development. New sources of dispute over "equity" are emerging as Japanese and other overseas producers have been gaining an increasing share of the North American market. Competition has escalated in the form of incentive payments to these offshore companies to persuade them to locate in the United States or Canada. In view of the greater resources at the disposal of the United States, Canadians are naturally concerned that they secure an equitable share of this new investment.[86]

Canadian-US differences over the Auto Pact demonstrate that a broader non-sectoral free-trade agreement, or other sectoral agreements, would require that an understanding be reached on "unequal treatment". A major source of US disagreement with both Canada and Mexico has related to how "temporary" agreements ensuring unequal treatment should be. The United States has argued that Canadians should "graduate" from the safeguards of the Auto Pact; and Mexicans have been pressured to "graduate" from the generalized system of preferences and into GATT membership. Despite the major differences in Canadian and Mexican development levels, each country is a subordinate state in a disparate dyad with the United States. US recognition that Canada and Mexico must be permitted to compensate for their asymmetrical positions is vital to the trade interests of the two smaller countries. In some respects, each country might learn from the compensatory mechanisms developed by the other.

Conclusion

This study deals with "non-traditional" areas of comparison in Canadian foreign policy. Latin America has not been an area of traditional concern for Canada and, as a more developed North Atlantic country, Canada is more frequently compared with states in the OECD.

Current economic conditions would also appear to set the two countries apart. Although the Canadian economy has been severely affected by the global recession, Mexico's problems are of a much higher order of magnitude. Despite Canada's positive balance of trade in recent years, it has had a sizeable current account deficit, averaging Cdn. $4.6 billion from 1975 to 1979. This deficit has resulted from interest and dividend payments, other service charges and the financing of takeovers of foreign-owned companies.[87] As serious as these problems are, they are difficult to compare with Mexico's foreign debt exceeding $85 billion which brought the country to virtual default in 1982.

If one looks beyond the current difficulties, however, the importance of comparative studies of Mexican and Canadian policies towards the United States becomes more evident. In spite of the dire predictions in various press reports concerning economic and political instability in Mexico, prospects that the country will repay its debts have improved. Mexico's exports increased and its imports declined in the first half of 1983, yielding a foreign trade surplus of $6 billion.

The imposed austerity measures have inevitably had negative effects such as a declining economic growth rate; but the prospect is that Mexico will eventually derive greater benefit from its massive petroleum reserves.[88]

In assessing Mexico's potential for growth, the country's classification as a newly-industrializing country (NIC) is also significant. The OECD director for development co-operation has described the NICs as forming:

> a highly heterogeneous group with respect to geography, per capita income and development policies. But all are characterised by rapid growth in the level and share of industrial employment, expansion of export market shares in manufactures, and real per capita income levels which are approaching those of some of the advanced industrial countries.[89]

The proportion of world industrial production accounted for by 10 NICs, increased from 5.4 per cent in 1963 to 9.3 per cent in 1977; Mexico's share rose from 1.04 per cent in 1963 to 1.45 per cent in 1977.[90] By 1976, Mexico and Latin America's two other NICs--Brazil and Argentina--accounted for 70 per cent of that region's industrial exports.[91] The growing presence of the NIC group then, is an indication that it will become increasingly difficult to classify certain countries as "LDCs" or "industrial states".

Canada, with its high degree of foreign ownership, its sizeable deficit on current account and its growing trade deficit in end products can also be viewed as a "borderline" country in some respects. As discussed, in 1980 at least half the exports of most industrial countries were "finished manufactures"; this situation was true of Japan, Italy, Federal Republic of Germany, Sweden, the United States and France. In Canada's case, however, finished manufactures comprised only 32 per cent of its exports in 1980.[92] This monograph discusses the fact that Canadians, for historical, cultural, political and economic reasons, have been slow to recognize that they share certain problems with non-US countries in the Western hemisphere. As John Harbron has stated "The larger republics of Latin America may have with us. But these are rarely if ever described with any sense of community in Canadian media or by Canadian commentators."[93]

Even though there are indications that the economic differences between Canada and Mexico have narrowed in certain respects and may continue to do so in the future, the current divergencies between them are of course substantial. Nevertheless, we maintain that the United States as a common neighbour provided a major basis for comparison. The United States is of overriding economic importance to the two countries, and in both cases the relationships are highly asymmetrical (albeit more so in Mexican-US relations). Striking similarities are also evident in the two countries' agenda of economic concerns with their common neighbour. This study has focused on foreign trade issues, but comparative studies are also required of other economic areas such as foreign investment, energy and maritime issues.

In conclusion, Mexico and Canada have a sufficient number of shared economic concerns with the United States and there are mutual advantages to be gained from comparative analysis. One result of a broadened vision by both Canadians and Mexicans of "North America" could be a mutually beneficial expansion of linkages between the two smaller countries.

Notes

1. Quoted in John W. Holmes, *The Better Part of Valour: Essays on Canadian Diplomacy* (Toronto: McClelland and Stewart, 1970), 230.
2. Donald L. Wyman, "Dependence and Conflict in US-Mexican Relations 1920-1975" in *Diplomatic Dispute: US Conflict with Iran, Japan and Mexico*, edited by R. Paarlberg et al., pp. 83-141 at 121-2.
3. R. Paarlberg, "Introduction: Conflict and Interdependence" in *Diplomatic Dispute*, edited by Paarlberg et. al., pp. 11-14 at 13. Also see R. Keohane and J. Nye, *Power and Interdependence: World Politics in Transition*.

crisis without making concessions. See Peter C. Dobell, "Negotiating with the United States", International Journal 36 (No. 1 1980-1): 17-38.

9. "Statement of Hon. Pete V. Domenici, a US Senator from the State of New Mexico", Hearing before the Subcommittee on International Trade of the Senate Committee on Finance, US Congress, 96th Congress, 1st Session, 6 June 1979, North American Interdependence, 13.
10. Ibid., 14. Also see "Statement of the Chamber of Commerce of the United States" by William G. Phillips in Ibid., 88.
11. The "Contadora" group has called for regional negotiations and a halt to all foreign military intervention in Central America. The Group is named after the Panamanian island where its members, Colombia, Mexico, Panama and Venezuela, first met.
12. "Statement of Hon. Julius Katz, Assistant Secretary of State for Economic and Business Affairs" in North American Interdependence, 32-33.
13. Dobell, "Negotiating with the United States", 23.
14. The White House, Memorandum from the President, "Coordination of United States Policy toward Mexico", 26 April 1979.
15. Richard E. Feinberg, "Bureauratic Organization and United States Policy toward Mexico" in Mexico-United States Relations, edited by Susan Kaufman Purcell, pp. 32-42: Olga Pellicer de Brody, "La politica de Ronald Reagan hacia México; La dificil recuperacion de la buena vecindad" in Cuadernos Semestrales, Estados Unidos: perspectiva latinoamericana 9 (1981): 255-62.
16. J.C.M. Ogelsby, Gringos From the Far North: Essays in the History of Canadian-Latin American Relations 1866-1968 (Toronto: Macmillan Company of Canada, 1976), 1.
17. Holmes, Better Part of Valour, 227.
18. John D. Harbron, "Canada Draws Closer to Latin America: A Cautious Involvement", 116-17.
19. The other participants are the United States, Japan, West

4. Victor L. Urquidi, "Prospects for Further Development of Economic Relations among Mexico, Canada and the United States", 1.
5. For Mexico see Marie Claire Fischer de Figueroa, compiladora, Relaciones México-Estados Unidos, Bibliografia Anual (México, D.F.: El Colegio de México, 1982); Estados Unidos: perspectiva latinoamericana, monthy (México, D.F. Centro de Investigacion y Docencia Economicas (CIDE), monthly); US-Mexico Project Series Working Papers (Washington, D.C.: Overseas Development Council); Working Papers in US-Mexican Studies (LaJolla: University of California, San Diego). For Canada see Jane R. Barrett and Jane Beaumont, compilers, A Bibliography of Works on Canadian Foreign Relations 1976-1980 (Toronto: Canadian Institute of International Affairs, 1982); two earlier bibliographies on Canadian foreign relations compiled by Donald M. Page, and Lawrence Motiuk and Madeline Grant. These are also published by the Canadian Institute of International Affairs, publications of the Canadian-American Committee and the Howe Institute Policy Analysis Committee (Montreal: C.D. Howe Institute). H. Edward English discusses this point in "A Canadian Perspective on North America's Economic Relations", International Studies Association Conference, Mexico City, 9 April 1983.
6. Kenneth N. Waltz, "The Myth of National Interdependence" in The International Corporation, edited by Charles P. Kindleberger (Cambridge, Mass.: M.I.T. Press, 1970), at 220.
7. Annette Baker Fox, The Politics of Attraction: Four Middle Powers and the United States (New York: Columbia University Press, 1976), 2.
8. Canada was shocked to find itself a major target of Secretary of the Treasury John Connally, when the United States demanded concessions in August 1971. However, we maintain that the larger West European states and Japan were the principal US

Germany. France, Britain and Italy. Unless otherwise indicated, dollars in this study are in US currency.

20. Harbron, "Canada Draws Closer to Latin America", 115.

21. See Ibid., 126; I.A. Litvak and C.J. Maule, "Foreign Investment in Mexico: Some Lessons for Canada".

22. Gerard Barnier, ISA Conference, Mexico City, 5 April 1983.

23. Quoted in Laura R. Randall, "Mexican Development and Its Effects upon United States Trade" in Mexico and the United States, edited by Robert H. McBride (Englewood Cliffs, N.J.: Prentice-Hall, 1981), 71.

24. Canada, Standing Senate Committee on Foreign Affairs, Canada-United States Relations, Volume III: Canada's Trade Relations with the United States, 39-44.

25. Bruce M. Bagley, "A United States Perspective" in Mexico-United States Relations, edited by S. Purcell, pp. 13-27. Also see Alicia Puyana, "La Idea del Mercado Comun de América del Norte y las Implicaciones para México" in Lorenzo Meyer, compilador, México-Estados Unidos 1982 (México, D.F.: El Colegio de México, 1982), pp. 131-64. This article provides a detailed analysis of the potential effects of a tripartite common market on Mexico.

26. Quoted in Robert H. McBride, "The United States and Mexico: The Shape of the Relationship" in Mexico and the United States, edited by R. McBride, 19. Also see Dale Story, "Trade Politics in the Third World: A Case Study of the Mexican GATT Decision", 777.

27. Standing Senate Committee on Foreign Affairs, Canada-United States Relations, Volume III, 113.

28. J. Holmes, Life with Uncle: The Canadian-American Relationship, 79.

29. Canada, Department of Industry, Trade and Commerce, Canada's Export Development Plan for Mexico, April 1981, 1 and 28.

30. Christopher Tugendhat, The Multinationals (Middlesex: Penguin Books, 1971), 51.

31. Elliot J. Feldman, Canada and Mexico: The Comparative and Joint Politics of Energy, Report of a Symposium held 9-10 April 1981 at Harvard University's Center for International Affairs (Cambridge: University Consortium for Research on North America, 1981), 43.
32. World Bank, World Development Report,1983 (New York: Oxford University Press for the World Bank, 1983), 164-65.
33. See Sperry Lea, A Canada-US Free Trade Arrangement: Survey of Possible Characteristics (Washington, D.C.: Canadian-American Committee, 1963); and A Possible Plan for a Canada-US Free Trade Area--A Staff Report (Washington, D.C.: Canadian-American Committee, 1965); Ronald J. Wonnacott and Paul Wonnacott, Free Trade between the United States and Canada: The Potential Economic Effects (Cambridge, Mass.: Harvard University Press, 1967); Economic Council of Canada, Looking Outward--A New Trade Strategy for Canada (Ottawa: Economic Council of Canada, 1975); Standing Senate Committee on Foreign Affairs, Canada-United States Relations, Volumes II and III "Canada-United States Trade and Policy Issues", Special issue of Canadian Public Policy 8 (Supplement, October 1982).
34. Sidney Weintraub, "US-Mexican Economic Integration", The Mexican Forum 2 (October 1982): 4-7. See also S. Weintraub, Free Trade between Mexico and the United States?
35. Canada-United States Relations, Volume III, 5.
36. Source of the data is Banco Nacional de Comercio Exterior, S.A., and does not include "maquiladoras" or the border assembly plants. See Maria Celia Toro, "El Comercio México-Estados Unidos. La Realidad Desigual y los Limites a la Colaboracion Norteamericana" in La Política Exterior de México: Desafíos en los Ochenta, edited by Olga Pellicer de Brody, (Mexico, D.F.: CIDE, 1983). Also see Arturo Ortiz Wadgymar, "Evolucion de las relaciones comerciales entre México y lor Etados Unidos" and Armando Cortés Guzman, "Aspectos relevantes en las relaciones comerciales México-EEUU" in Relaciones México-Estados

Unidos, edited by Alonso Gomex-Robledo Verduzco, pp. 71-198 (México: UNAM, 1981).

37. World Bank World Development Report, 1982, Table 9.

38. Glen Williams, Not for Export: Toward a Political Economy of Canada's Arrested Industrialization (Toronto: McClelland and Stewart, 1983), 6-11.

39. "Crude materials" are "raw unprocessed products such as coal or iron ore"; fabricated materials" are "crude materials or other commodities which have been processed but are not yet an end product"; "end products" are "fully manufactured products which are ready for use by the consumer or in the assembly of another end product." See Canada-United States Relations, Volume III and James Laxer, Canada's Economic Strategy (Toronto: McClelland and Stewart, 1981).

40. David R. Mares, unpublished paper on Mexican trade policy.

41. Maria Celia Toro, "El Comercio México-Estados Unidos", 187-90.

42. Canada-United States Relations, Volume II, 6.

43. A.R. Moroz and K.J. Back, "Prospects for a Canada-United States Bilateral Free Trade Agreement: The Other Side of the Fence", 841.

44. Sidney Weintraub, "US-Mexican Trade: Situation and Outlook" in United States Relations with Mexico--Context and Content, edited by Richard D. Erb and Stanly R. Ross, pp. 179-194, (Washington, D.C.: American Enterprise Institute, 1981), at 181.

45. Item 806.30 provides that metal articles (except precious metal) manufactured in the United States, exported for processing, and re-imported to the US for further processing are subject to duty only on the value of foreign processing. Item 807.00 provides that imports assembled in foreign countries incorporating US-made components are subject to duty at full value minus the value of the American-made components.

46. United States International Trade Commission, Background Study of the Economies and International Trade Patterns of the

Countries of North America, Central America and the Caribbean, 160-62.

47. Manuel Martinez del Campo, "Ventajas e inconvenientes de la actividad maquiladora en México", Comercio Exterior 33 (February 1983): 146-51; C. Daniel Dillman, "Assembly Industries in Mexico: Contexts of Development", Journal of Interamerican and World Affairs 25 (No. 1 1983): 31-58. The extensive amount of literature on the "maquiladora" is catalogued in Jorge V. Carrillo y Hernandez H. Alberto, La Industria Maquiladora en México: Bibliografia, Directorio e Investigaciones Recientes, Monographs in US-Mexican Studies No. 7, (La Jolla: University of California, San Diego, 1981).

48. David Stewart-Patterson, "2.9 billion auto trade", Globe and Mail, 23 March 1983, p. B1. Canada, External Affairs, "Relations between Canada and the USA", Canadian Foreign Policy Texts 83/2, April 1983 (revised October 1983), 3.

49. Canada-United States Relations, Volume II, 103-4. Despite the Senate Committee statement, Minister Herb Gray did go to Washington for consultations on the Auto Agreement after he took office in 1980.

50. Stephen D. Krasner, "Structural causes and regime consequences: regimes as intervening variables", International Organization 3 (No. 2 1982): 185-205 at 188.

51. "Statement of Gerard J. Van Heuven, Executive Vice President, United States-Mexico Chamber of Commerce", in North American Interdependence, 77.

52. Randall, "Mexican Development", 67; D. Story, "Trade Politics in the Third World: a case study of the Mexican GATT decision", 793.

53. Dillman, "Assembly Industries in Mexico", 50. Also see Richard L. Bolin, "World Competition for the US 806/807 Market", Journal of Flagstaff Institute 3 (July 1979): 1-10.

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55. Peyton V. Lyon and Brian W. Tomlin, Canada as an International Actor (Toronto: Macmillan of Canada, 1979), 122-7.
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57. "Canada-US Relations: Options for the Future", International Perspectives, Autumn 1972.
58. Edward J. Williams, "US-Mexican Energy Relations: Ambiguity and Fragility" in US-Mexican Energy Relationships: Realities and Prospects, edited by Jerry R. Ladman et al., pp. 3-16 (Lexington, Mass.: D.C. Health and Company, 1981) at 7.
59. Donald J. Daly, Canada in an Uncertain World Economic Environment (Montreal: The Institute for Research on Public Policy, 1982), 13-15. John Kirton and David Dewitt indicate that there has been some trade diversification away from the United States since 1969, but the data they use are inconclusive. The share of Canadian exports to the US declined by only 0.2 per cent between 1969 and 1977. See David B. Dewitt and John J. Kirton, Canada as a Principal Power: A Study in Foreign Policy and International Relations, 157.
60. "The disappearing dollar", Globe and Mail 3 June 1982, p. 6.
61. James Rusk, "Ottawa to expand trade links with US 'partner' ", Globe and Mail 1 September 1983, pp. 1-2.
62. Daniel Levy and Gabriel Székely, Mexico, Paradoxes of Stability and Change (Boulder, Colo.: Westview Press, 1983), 191.
63. Jennifer Lewington, "Canada, Europe count on rebound in trade", Globe and Mail 20 June 1983, p. B1. Mark Lukasiewicz, "Slump in trade to Europe grows worse", Globe and Mail 25 July 1983, p. B1.
64. A. Gotlieb and J. Kinsman, "Reviving the Third Option", International Perspectives (January/February 1981): 4.
65. Gustavo Vega Canovas, "Las Exportaciones Mexicanas y El Neoproteccionismo Norteamericano" in México-Estados Unidos 1982 by L. Meyer, 33-58.

66. Melvyn B. Kraus, The New Protectionism: the Welfare State and International Trade (New York: New York University Press for the International Centre for Economic Policy Studies, 1978), 36. Also see Andrzej Olechowski and Gary Sampson, "Current Trade Restrictions in the EEC, the United States and Japan", Journal of World Trade Law 14 (No. 3 1980): 220-31.

67. Story, "Trade Politics in the Third World", 776-77. Gary C. Hufbauer, W.N. Harrell Smith IV, and Frank G. Vukmanic, "Bilateral Trade Relations" in Mexico-United States Relations, edited by S. Purcell, pp. 136-45. Manuel Armendariz and Eric Alvarez, A Mexican View of US Protectionism, US-Mexico Project Series No. 13, (Washington, D.C.: Overseas Development Council, 1982).

68. Holmes, Life with Uncle, 73.

69. See Fred Lazar, The New Protectionism: Non-Tariff Barriers and their Effects on Canada (Toronto: James Lorimer & Company, 1981), 7. During the Tokyo Round, sectoral agreements were instituted for certain agricultural products and civilian aircraft.

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73. Peter C. Dobell, "The Influence of the United States Congress on Canadian-American Relations" in Canada and the United States: Transnational and Transgovernmental Relations, edited by A. Fox et al., pp. 310-36 (New York: Columbia University Press, 1976), at 334.

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81. Olga Pellicer de Brody, The Foreign Trade Policy of the United States Government toward Mexico: Are There Reasons for Expecting Special Treatment? Working Papers in US-Mexican Studies No. 9, (La Jolla: University of California, San Diego, 1981), 7.

82. This section relies extensively on Story, "Trade Politics in the Third World".

83. John F.H. Purcell, "Trade Conflicts", 4-5.

84. Lazar, The New Protectionism, 28.

85. Gary C. Hufbauer and Andrew J. Samet, "Investment Relations between Canada and the United States" in Canada and the United States: Dependence and Divergence, edited by W. Armstrong et al. (Cambridge, Mass.: Ballinger Publishing Company, 1982), 132-42.

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89. Helmut Führer, "Industrialisation of the Third World", The OECD Observer 102 (January 1980): 24.

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91. Colin I. Bradford, Jr., "Newly Industrializing Countries in an Interdependent World", The World Economy 5 (No. 2 1982): 171-85, at 171-73.

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Table 1: Canada's Major Trading Partners, 1980

Major Importers	$ (million)	%	Major Exporters	$ (million)	%
United States	41,068	61.0	United States	41,201	68.2
Japan	3,751	5.6	Japan	2,384	3.9
United Kingdom	2,713	4.0	Saudi Arabia	2,087	3.5
Germany (FRG)	1,388	2.1	Venezuela	1,863	3.1
USSR	1,303	1.9	United Kingdom	1,682	2.8
Netherlands	1,213	1.8	Germany (FRG)	1,233	2.0
France	863	1.3	France	655	1.1
Italy	848	1.3	Italy	520	0.9
Belgium	832	1.2	Hong Kong	491	0.8
China (PRC)	742	1.1	Switzerland	445	0.7

Source: Derived from International Monetary Fund, Direction of Trade Statistics - Yearbook 1982, pp. 108-10.

Table 2: Mexico's Major Trading Partners, 1980

Major Importers	$ (million)	%	Major Exporters	$ (million)	%
United States	9,688	63.2	United States	12,814	65.6
Spain	1,062	6.9	Japan	1,039	5.3
Japan	563	3.7	Germany (FRG)	1,021	5.2
Israel	507	3.3	France	543	2.8
Netherlands Antilles	459	3.0	Spain	455	2.3
Brazil	349	2.3	Brazil	440	2.3
France	272	1.8	United Kingdom	426	2.2
Germany (FRG)	256	1.7	Canada	371	1.9
Italy	210	1.4	Italy	321	1.6
Canada	163	1.1	Switzerland	196	1.0

Source: Derived from International Monetary Fund, Direction of Trade Statistics - Yearbook 1982, pp. 264-65.

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2: SOVIET-CANADIAN TRADE: THE POLITICS OF INTER-VULNERABILITY

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and
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SOVIET-CANADIAN TRADE: THE POLITICS OF INTER-VULNERABILITY

Introduction

The 1970s witnessed a dramatic and rapid expansion in trade between the Communist countries and the non-Communist world. East-West trade increased sixfold in value in the 1970-1979 period.[1] Total Soviet-Canadian trade expanded at a similar pace with trade turnover (i.e., exports plus imports) increasing from $110 million in 1970 to $825 million in 1979.[2] However, the decade that began with such promise and hope ended on a note of tension and despair. By the late 1970s, détente was in tatters. A steady deterioration in East-West relations was capped by the Soviet invasion of Afghanistan in December 1979 and the imposition of martial law in Poland in December 1981, actions that provoked Western outrage, triggered various economic sanctions and hindered the further development of trade.

This paper examines the prospects for Soviet-Canadian trade in the uncertain years ahead; it is divided into two major parts. Since Soviet-Canadian economic relations are so much a product of the general stance adopted by the Soviet Union toward the Western world, the first section of this paper discusses some of the broad economic and political factors that will shape Soviet policies in the mid-1980s. Within this context, the second section focuses more specifically on Soviet perceptions of Canada and its economic policies toward this country.

The Soviet Union and the World Economy

If one compares the 1980s with the 1970s, it is apparent immediately that the prospects for increased trade have declined sharply. The early 1970s were an unprecedented period in that a number of favourable economic and political trends converged in a mutually reinforcing manner which strongly impelled the Soviet Union to expand its economic relations with the West. In contrast, at the present time virtually all these factors no longer pertain, and the prospects for the immediate future are not very encouraging.

By the early 1970s, the Soviet leadership had decided that the best way to achieve desired improvements in the efficiency and productivity of the Soviet economy was by an unprecedented reliance upon Western imports.[3] To spur the lagging Soviet economy, it was decided to import vast quantities of advanced Western technology including large numbers of complete factories to be built and equipped with Western assistance. At the same time, it was recognized that enhanced productivity also hinged upon improvements in the morale and motivation of the working force, something that could be achieved only by a sustained improvement in the standard of living, especially the increased availability of meat and other food products. In turn, it was decided that the fastest and most efficient means of increasing meat production was through the importation of huge quantities of feed grains since Soviet conditions (both climatic and systemic) caused domestic production to be inadequate and very costly.

Fortunately for the Soviets, this heightened interest in purchasing Western technology and grain was matched by favourable developments that greatly enhanced the Soviet Union's ability to obtain the hard currency needed to pay for these imports. In the 1970s, two of the Soviet Union's major exports--oil and gold--jumped tremendously in value, providing the Soviet Union with a windfall of many billions of dollars. In addition, Western banks that were awash in petro-dollars were eager to loan funds to virtually all takers, including the Communist world.

Favourable political developments reinforced these economic trends. With the advent of détente, Western nations were willing to relax previous restrictions on trade and the extension of credit to the Communist world. Détente also served to lessen the Kremlin's fears that the abandonment of the Soviet bloc's relative self-sufficiency would make it vulnerable to Western economic pressure. In addition, it was Moscow's expectation that an increase in East-West trade would strengthen the vested interests of influential capitalist groups in the maintenance of improved relations with the Soviet Union, improve the international political climate, demonstrate to skeptics in the West that mutually beneficial co-operation was indeed possible, and thus provide a firm foundation for the further expansion of détente.

In the early 1980s, economic and political factors were again moving in tandem, but this time in the opposite direction toward the constriction of East-West economic relations. A weakening in the Soviet economy was matched by the erosion of the political foundations of détente. Doubts were increasingly voiced in the West about both the economic and political wisdom of extensive trade with the Soviet Union. Although a significant improvement in the international climate at some time in the near future is not inconceivable--especially given the pendulum swings of Western public opinion and the possibility of a new US president in 1985--current economic and political trends are not very auspicious. For reasons that we will now discuss, it would appear that East-West trade in general and Soviet-Canadian trade in particular are not likely to expand significantly during the mid-1980s.[4]

By far the most important factor constricting East-West trade is the difficulty the Soviet Union faces in obtaining sufficient hard currency with which to pay for its imports. The Soviet Union's good fortune during the 1970s is unlikely to be duplicated in the years ahead. International bankers who previously dispensed money with reckless abandon are now deeply concerned about the precarious position of several East European nations, most notably Poland, Romania and Yugoslavia, and this spills over to their appraisal of the Soviet economy. Even though the Soviet Union has huge gold reserves, a moderate debt service ratio and is not itself overextended, the current economic and political climate precludes large-scale Western loans to the Soviet Union in the years ahead.[5] During the 1970s, the Soviet Union's net hard currency debt expanded by approximately $10 billion.[6] Allowing the Soviet Union to increase its purchase of foreign technology and grain provided an important stimulus to its trade with the West, a stimulus that is almost certain to be absent in the near future.

Two of the Soviet Union's most important sources of hard currency earnings are petroleum and gold. The Soviet Union benefited enormously from the soaring prices for these raw materials in the 1970s. In the 1970-1978 period Soviet exports of petroleum products increased 1.6 times in tonnage, but 14.8 times in value.[7] Similarly, from 1971 to 1978, gold exports rose 7.2 times in volume, but 46.5 times in value.[8] By 1980, the export of oil was accounting for one-half of the $20 billion in hard currency earned annually by the Soviet Union (not counting arms sales and gold), while gold sales in 1981 brought in an estimated $2.5 billion.[9] The prospects for the mid-1980s are not nearly as favourable. Gold prices will increase moderately at best. Petroleum prices are unlikely to increase significantly and may well continue to remain below the peak of more than $35 per barrel reached in 1980-1981.

Even more significant is that the quantity of Soviet oil exports is likely to experience a sizeable drop by the end of the 1980s.[10] Earlier pessimistic CIA predictions that Soviet oil production would soon plummet and that the USSR would become a major net importer of oil by 1985 have not been fulfilled. However, Soviet oil production has definitely plateaued. Since 1980, oil production has expanded at less than 1 per cent per year,[11] unlike the 1960s and 1970s when annual increases of 7 per cent and 8 per cent were common.

As far as hard currency is concerned, the Soviet Union faces a number of adverse trends. Foreign loans will be much harder to obtain, the price for gold and oil is unlikely to increase substantially, and the amount of oil available for export may drop significantly. On the positive side, however, is the rapid growth of Soviet natural gas production much of which is destined for the export market. It is estimated that the Soviet Union possesses 35 per cent to 40 per cent of the world's reserves of natural gas.[12] The 1981-1985 Five-Year Plan projects that output will increase at an annual rate of 7 per cent to 8 per cent and, thus far, this ambitious target has been met.[13] By the latter part of this decade, the Soviet Union will be earning $4 billion to $8 billion from gas exports to Western Europe.[14]

On balance, the Soviet ability to import from the West is likely to remain at approximately its present level for a number of years. The dramatic upsurge of the 1970s will not be repeated but, unless adverse political developments intervene (a question discussed below), a precipitous drop in the Soviet ability to pay for purchases from the West is unlikely to occur. It is this projection of a stabilization in Soviet hard currency earnings that provides the main basis for anticipating a corresponding leveling off in Soviet imports from the West.

Even if the Soviet Union maintains its ability to pay for Western imports in the years ahead, will it have the same need for foreign goods? It is of particular importance to Canada to ascertain whether the Soviet Union will continue to purchase massive quantities of grain on the world market. Bad news for the Kremlin means good news for the Canadian farmer, and the intractable weakness of Soviet agriculture strongly points to a continuance of the present high level of Soviet grain purchases.

It is easily forgotten that, prior to 1972, the Soviet Union was generally a net exporter of grain. During the 1960-1970 period, the Soviet Union was a net exporter of grain in eight out of ten years; as late as 1970-1971 it exported more than seven million metric tonnes.[15] Two major developments changed this situation--a series of poor harvests (in 1975, and in 1979 through 1982) and the Kremlin's decision to improve the Soviet standard of living by increasing the amount of meat available for consumption. Between 1970 and 1980, the quantity of grain directly consumed by the Soviet population increased by only two million metric tonnes, but the use of feed grain increased by over 25 million tonnes. As a result, by the end of the 1970s, the Soviet Union was importing over 30 million tonnes annually.[16] In 1981, the Soviet Union spent some $12 billion on grain and other agricultural products, almost one-half of its hard currency earnings.[17]

As evidenced by the targets set for the 1981-1985 Five-Year Plan, the Soviet leadership would very much like to increase domestic production of meat and grain and lessen the costly dependence upon foreign sources of supply. However, after the dismal harvests of 1981 and 1982, it is already clear that the Plan's targets are beyond reach. It is extremely difficult to overcome the handicaps under which Soviet agriculture labours. Soviet farmers are bedeviled by irregular weather patterns, inadequate irrigation, marginal soil conditions in many areas, machinery that often breaks down, an aging rural population and an economic system that does little to encourage individual initiative.[18] The Soviet Union's cold climate is not conducive to growing corn, a major feed grain, and the system of transportation and storage is so antiquated that as much as 20 per cent to 25 per cent of perishable foodstuffs spoil and never make it to market.[19]

Despite the leadership's deep concern about this situation, not much is likely to change in the near future. A massive infusion of investment capital into the agricultural sector in the 1970s brought only limited gains, and the 1981-1985 Plan does not project more than a modest increase in resources devoted to the countryside.[20] Whatever Andropov's reformist leanings may be, the forces of conservatism and inertia are likely to preclude a dramatic change in the management of Soviet agriculture.

Even the weather may be conspiring against the Soviet Union. Some climatologists have suggested that the benign weather from which the Soviet Union benefited so much in 1963 to 1974 has ended, and that the harsh conditions of the post-1974 period are more representative of what the Soviet Union will face in the years ahead.[21] Since Soviet agriculture is overly centralized, bureaucratically inflexible and has inadequate reserves of fertilizer and machinery, the margin for error is not very wide. As a result, poor weather conditions, such as occurred between 1979 and 1982, have a devastating effect. All in all, the outlook for Soviet grain production in the years ahead is not very favourable.

Faced with this situation, the Soviet leadership has two basic alternatives. It can cut back sharply on efforts to improve the Soviet diet, or continue its massive imports of grain. In Stalin's day there was little concern about the people's standard of living, but this is no longer the case. The current leadership recognizes that in order to improve efficiency and productivity--objectives that are at the heart of current economic planning--it is necessary to strive to satisfy the rising expectations of the populace. Tangible economic rewards--and above all an adequate supply of meat and food--are necessary to reduce absenteeism, a high rate of job turnover, an epidemic of alcoholism and indifference to quality control.

In addition, with the lesson of Poland fresh in mind, the Soviet Union's rulers are fully aware of the potentially explosive consequences of inadequate supplies of meat and consumer goods. Although the Soviet population has traditionally been more quiescent than the Poles, a number of spontaneous slowdowns and strikes have reportedly taken place in the Soviet Union to protest meat shortages and other grievances.[22] Not wishing to see a return to the uncontrolled terror of the Stalin years, the Soviet leadership must make a major effort to put increased quantities of meat on Soviet tables, and hence the Kremlin has little choice but to continue large-scale grain imports from the West.

Thus far we have examined some of the economic factors that will influence the Soviet approach to international trade in the years ahead. However, it is necessary to say a few words about political factors as well. East-West trade remains highly politicized and the international climate, be it one of détente or tension, will have a major impact on economic relations between the Soviet Union and the Western world. In this context, three major questions need to be addressed briefly:

- Will the major Western nations, in responding to the general state of East-West relations, attempt to expand or restrict trade with the Soviet Union?
- What stance will the post-Brezhnev leadership adopt toward economic relations with the capitalist world?

- Will Andropov and his colleagues adopt a program of internal economic reform, and if they do, how will this affect commercial relations with the outside world?

As difficult as it is to project economic trends, the anticipation of political developments is even more problematical. In the 30 years since Stalin's death, East-West relations have resembled a turbulent roller coaster ride. Short-lived détentes (such as those of 1953-1955, 1959-1960, and 1963-1964) have aroused fervent hopes for an end to the Cold War, only to be dashed by a rapid descent into crisis and confrontation.

At the present time, we find ourselves in a gray twilight zone. Western governments and bankers are no longer eager to advance billions of dollars in credits to Eastern Europe and the Soviet Union, and the trend toward the relaxation of Western restrictions on trade with the Soviet Union has come to an abrupt halt. At the same time, US efforts to employ direct economic sanctions to punish the Soviet Union for the invasion of Afghanistan and the imposition of martial law in Poland have received little support within the Western alliance. For this reason, the US grain embargo of 1980-1981 was a notable failure, as was their attempt in 1982 to delay the building of the natural gas pipeline between the Soviet Union and Western Europe. As a means of hobbling the Soviet economy, the Reagan Administration would like to tighten restrictions on trade with Moscow, but most major Western governments (including Canada) lean toward the maintenance or even modest expansion of current levels of East-West trade. Given this balance of forces within the NATO alliance on the one hand, and the unlikelihood of a new round of détente fever on the other, Western policy in the years immediately ahead seems destined to continue its present course, neither seeking to expand dramatically nor endeavouring to restrict fundamentally economic relations with the Soviet Union.

The Soviet leaders, like their Western counterparts, are now much less sanguine about the economic and political benefits of East-West trade. No longer do they believe that a massive infusion of Western technology will provide a "quick fix" enabling Soviet industry to rapidly overcome bottlenecks and low productivity.[23] Similarly, it is now recognized in Moscow that an increase in Soviet-US trade can have only a limited impact on the improvement of relations between the superpowers. Earlier Soviet hopes that the captains of Wall Street would become so enamoured of Soviet markets that they would throw their considerable political weight behind the pursuit of détente have diminished greatly. Thus the Soviet Union no longer has the same political incentive to expand Soviet-US trade.[24] In addition, the US attempt to apply economic sanctions has made Moscow more wary of the dangers of excessive dependence upon a single source of supply and more interested in diversifying its economic relations with Western countries.

Yet these reduced expectations about the benefits of East-West trade and heightened concerns about the potential dangers of dependence have not led to any fundamental reorientation in Soviet foreign trade practices. Although Western technology is no longer regarded as a panacea, it is still valued as a useful stimulant for an ailing economy. Unable to produce sufficient grain domestically, Moscow has little choice but to buy from the West. Paradoxically, the net effect of Washington's unsuccessful attempt to embargo grain may be to reassure the Soviets that, as long as they diversify their sources of supply, there is little to fear. Western disunity and the political clout of millions of farmers ensure that a co-ordinated embargo will not come about. Thus large-scale Soviet grain imports are likely to continue, and non-US suppliers such as Canada and Argentina will be the major beneficiaries.

The central economic problem currently facing the Soviet Union is the steady decline in its rate of growth. In the 1950s, the Soviet GNP expanded at an impressive rate of almost 6 per cent per year. By the 1960s, this dropped to little more than 5 per cent, and by the 1970s it was less than 3.5 per cent.[25] During the 1979-1982 period, the growth of the Soviet GNP was in the 1 per cent to 2 per cent range.[26] Brezhnev's successor, Yuri Andropov, wasted no time in focusing attention upon this unacceptable situation but it is highly uncertain as to whether he will be able to go beyond exhortation to concrete economic reform.

The barriers to innovation in the Soviet economy are immense, and the failure of past attempts does not lead to optimism concerning the effectiveness of future initiatives. However, meaningful economic reform would stimulate East-West trade. Western technology would occupy a prominent place in Soviet efforts to increase productivity. Reformist elements within the Soviet leadership are likely to be less fearful of Western subversion and ideological contamination than their more conservative colleagues.[27] In the long run, if the quality of Soviet manufactured goods can be improved, the Soviet Union will be better able to sell its products abroad, thereby earning the hard currency needed to finance imports. A desire to reform the economy might also lead to a heightened interest in curbing military expenditures so that scarce capital and manpower would be freed for other tasks. This in turn would lessen Western anxieties about the Soviet military threat and lead to a significant improvement in East-West relations. Should this train of developments result in a rebirth of détente, Western trade with the Soviet Union would receive a further impetus.

However, despite the undeniable seriousness of current Soviet economic problems, it is by no means certain that the Politburo with its extremely conservative and cautious outlook, will embark upon meaningful reform. Moreover, changes in Soviet institutions and practices would not be accomplished overnight, and East-West trade would be unlikely to benefit prior to the end of the 1980s.

In summary, the main conclusions of this overview of Soviet policy toward East-West trade are as follows:

- Due to the Soviet Union's chronic shortage of hard currency, an expected stabilization in the price of energy and gold, the decreased availability of foreign loans and the demise of détente, Soviet trade with the West will not experience a significant increase during the mid-1980s.
- Nonetheless, a moderate debt service ratio and a continued ability to export arms, gold and energy--with increases in the sale of natural gas compensating for a decline in

oil--suggest that the Soviet Union will continue to earn sufficient foreign currency to maintain imports from the West at a level approximating that of 1980 (i.e., $26 billion).[28]

- The inability to increase agricultural production dramatically combined with an interest in improving the Soviet diet will result in the continuation of large-scale purchases of Western grain.
- Political tensions between Moscow and Washington and the desire not to be dependent upon a single supplier will cause the Soviet Union to continue to diversify its sources of grain. This policy will be of major benefit to Canadian grain producers.
- For the immediate future, any economic reform instituted in the Soviet Union is unlikely to be of a scale sufficient to generate large increases in either Soviet imports or exports.

The Soviet Union and Canada

Canadian Trade with the USSR: An Overview of Recent Patterns

The trends and most important issues in the Soviet Union's relationship with Canada are closely linked with the general pattern of East-West relations discussed above. Soviet-Canadian bilateral relations are also characterized, however, by a number of special features that have contributed to a rather distinct Soviet view of Canada's role and position in the "capitalist camp" and have affected the co-ordination of Canadian foreign affairs and foreign trade policy with the other countries of the Western alliance. This section will examine briefly various dimensions of the Soviet-Canadian relationship during the last two decades which help to explain the current and probable future pattern of trade between the two countries.

Moscow's decision to import large quantities of Western grain beginning in the 1960s, and subsequent Soviet initiatives for East-West détente and trade were two important factors setting the stage for serious Soviet attention to Canada. The much-heralded exchange of visits between Prime Minister Trudeau and Premier Kosygin in 1971 facilitated the general onset of the détente process and provided a further impetus to the expansion of Soviet-Canadian trade. As Table 1 indicates, the volume of Soviet trade with Canada climbed rapidly in the mid-1960s, and these early levels of trade doubled and tripled during the halcyon days of détente in the mid-1970s.

Three rather striking aspects of Soviet-Canadian trade in this period are important. First, despite an overall pattern of rapid growth during the last 15 years, Canadian-Soviet foreign trade represents only a small proportion of each country's total foreign trade. In 1979 for example, when the level of total Canadian exports to the USSR increased approximately one-third from the previous year, the total value of those goods exported comprised only about 1.2 per cent of Canada's total exports. In 1979, imports from the Soviet Union amounted to only 0.1 per cent of total Canadian imports. By 1982, after the negotiation of record-level trade agreements between Canada and the USSR, Canadian exports to the Soviet Union were still only 2.5 per cent of total Canadian exports, and the equivalent figure for imports had actually dropped to 0.06 per cent. Correspondingly, Soviet trade with Canada amounted to only a fraction of total Soviet foreign trade (for example, 0.5 per cent almost every year after 1969) and comprised a rather modest percentage of the USSR's total trade with capitalist countries. Within a group of 21 "developed capitalist states" trading with the USSR in 1976 for example, Canada occupied tenth place in terms of total trade turnover, ranking seventh in Soviet imports and 19th in exports (behind such smaller countries as Austria, Denmark, Greece and Norway).[29]

Second, Soviet imports of Canadian agricultural products (primarily wheat) have comprised the overwhelming portion of Canadian trade with the USSR. Soviet-Canadian trade in nonagricultural products grew markedly through most of the 1970s, but generally amounted to less than one-quarter of the total trade between the two countries. When USSR grain imports are left aside, Soviet-Canadian trade has been roughly balanced with overall Soviet imports slightly exceeding exports most years. Almost each year, therefore, the USSR is left with an enormous trade deficit with Canada which has resulted in a constant pressure, especially from Moscow, to achieve a more balanced pattern in total Soviet-Canadian economic relations. A breakdown of Canadian trade with the USSR in 1980-1982 illustrates the level of this imbalance and the mixture of commodities involved (Table 2). Thus, the recent overall growth in Canadian exports to the USSR was due to a large increase in Soviet purchases of grain. The sale of nonagricultural products to the USSR, particularly industrial machinery, actually dropped off in the early 1980s despite a small increase in Canadian exports of some crude materials (e.g., zinc, "radioactive" and other metal ores, as well as sulphur) and drilling machinery. The value of Canadian imports from the Soviet Union also decreased markedly in 1982. This decline was most noticeable with respect to Soviet end products such as machine tools, tractors, tractor engines, watches and jewelry, a trend not offset by increased Canadian purchases of motor vehicle parts from the USSR.

Finally, although the overall bilateral trade pattern was highly asymmetrical, the predominant agricultural trade component represented a very significant factor in both the Canadian and Soviet economies between 1972 and 1982. Soviet wheat imports from Canada accounted for between one-tenth to nearly one-quarter of total Canadian wheat exports in most years. During the same period, Canada supplied well over one-quarter of the USSR's total wheat imports. Canadian wheat exported to the USSR accounts, however, for only a small portion (about 2.5 per cent during the last 15 years) of total wheat available for consumption in the USSR (i.e., the Soviet's wheat harvest plus imports minus exports).[30] In relative terms, therefore, any discontinuation of the grain trade would involve a greater market loss for Canadian producers than for Soviet consumers. A concerted effort by all of the USSR's major wheat suppliers, if successful, would of course have a more adverse effect on the Soviet Union. Thus, although total Soviet-Canadian trade is small and heavily skewed toward one commodity, the growing importance of the grain trade to the economies of both countries has increased the extent of their interaction and reciprocal concern--or what may be termed inter-vulnerability--especially when routine international marketing of agricultural commodities is threatened or politically disturbed.

Soviet Perspectives on Trade with Canada

Soviet concern with Canada increased very noticeably during the 1970s stimulated by the USSR's political and economic interests and also the general atmosphere of East-West détente. An interesting manifestation of this concern was the growth in the volume and variety of Soviet research studies and discussions concerning Canadian affairs. Most of this activity has been based at the Institute of the United States and Canada of the Academy of Sciences in Moscow. This quasi-governmental/quasi-academic centre was established in 1968 and originally named the USA Institute. In 1974, however, stimulated by growing Soviet interest in Canada (and also by overtures from the Canadian side), an independent Canadian section (later a full department) was established at the Institute, which was also renamed the Institute for the USA and Canada (its major serial publication established in 1970 continued under the title USA Economics, Politics, Ideology). Headed by the politically influential Dr. Georgiy Arbatov, the Institute gradually emerged as a major "think-tank" for the Soviet specialists on North America, and by 1983 it had about 20 individuals working full time on Canadian questions.[31] The research and writing of the institutchiki concerned with Canada cover a wider range of topics including such specialized themes as Canadian submarine technology, the leadership of the Progressive Conservative Party, problems of Arctic development, nuclear policy and Canadian investment in the United States. An important portion of the work produced by Soviet Canadianists, however, has concerned foreign economic relations, and specifically questions of Canada's trade with the USSR. Although the studies and statements by such "pure scholars" and "scholar-operators" (i.e., international relations specialists with prior experience and interests in the political apparatus or "bureaucratic zones")[32] represent only one segment of the total "Soviet world view" and Soviet public opinion, such material can provide a fruitful body of source material with which to evaluate Soviet perspectives and interests regarding Canada.

It is a basic contention of Soviet Canadianists, not surprisingly, that US political and economic hegemony over North America is a principal factor explaining much of both Canadian domestic and external policy. Most Canadian policies are viewed as either approximations of, or reactions against, the views of Washington decision-makers and multinational corporations. As one reviewer of some recent Soviet literature on Canada aptly put it, the "overarching" perception of Canada is "of a large but weak capitalist state struggling in the Darwinistic schemes of the capitalist world to maintain its national political and economic sovereignty and self-identify against a malevolent, rapacious United States."[33] For Soviet commentators (and here distinctions between international relations specialists and more "popular" journalists are simply a matter of style and tone), US domination in North America both severely limits Canada's field of independent action--either because of overt pressure from Washington or lack of any will to resist in Ottawa--and also generates continuous rivalry and tension in Canada-US relations.[34] Soviet writers have happily chronicled Canada's "growing role on the North American continent" as well as in international affairs, but the Soviets frequently describe such Canadian self-assertion as "timid and inconsistent", cataloging the many forces that oppose independent Canadian activity such as "reactionary circles", "ethnic lobbies", "military cliques" and "US monopolists".[35]

The relatively simplistic perception of Canada as a subordinated and frustrated power is not, however, the only view put forward by Soviet authors. Recognizing Canada's genuine quest to shape a "third alternative" during the 1970s, as well as the considerable momentum in Canadian-Soviet political and economic relations that accompanied East-West détente, Soviet specialists on Canada have pointed to a number of specific problems that "objectively" have influenced the prospects for further trade with the USSR.

For example, a 1977 article written by two Soviet Canadianists, L.A. Bagramov and V.B. Povolotsky, listed a number of factors which, from their vantage point, obstructed the growth of commercial and economic ties between the Soviet Union and Canada.[36] Much of the discussion is representative of the problems frequently raised by Soviet observers such as the geographic distance between the two countries, Canada's association with the NATO Co-ordinating Committee's (COCOM) ban of "strategic goods" to the USSR, the "virtually non-existent" mechanisms for the promotion of business contacts on the non-governmental level, and US control over many Canadian companies. As a result of the "fairly deep economic integration of the North American States", the Soviet authors maintain that:

> the Canadian businessman feels it is more convenient to simply pick up the telephone receiver and quickly make a deal with one of his familiar partners in the United States than to search for a new partner and establish overseas contacts. In this connection, Canadian businessmen differ greatly from the businessmen in the United States, the FRG, France, Italy, and particularly Japan, who are famous for their enterprising and aggressive market strategy. The Canadians display particular caution in regard to our nation's market which is still terra incognita for many Westerners.[37]

They point out that foreign ownership of Canadian companies should not be seen entirely as an obstacle because US parent firms often use their affiliates and branches to circumvent US legislation complicating ties with the USSR.

The same Soviet writers also raise more complex economic issues inhibiting Canada's trade with the USSR. Canada's lack of a "high degree of production and capital concentration" and the presence of only a few "companies that can be regarded as industrial giants" (three firms, all affiliates of "American transnational monopolies") means, in their view, "that it would be unrealistic to give our Canadian partners large orders for a broad assortment of goods" or "to expect Canadian firms to take on the installation or delivery of complete sets of equipment for large Soviet projects."[38] The Soviet authors feel that it would be more advantageous for Canadian firms to construct facilities of average size in the USSR, or participate in a consortium for the construction of large facilities. A notable exception would be Soviet agreements with Canadian project planning or consultative firms (in fields such as mining, the oil industry, the pulp and paper industry, power engineering, transportation, communications and industrial and civil construction) which are seen as among the "leading firms of this type in the capitalist world". Although in the six years since these particular Soviet views were expressed a good deal of progress has been made in developing mechanisms for trade between Canada and the USSR, the general Soviet perceptions about problems of Canadian trade do not appear to have fundamentally changed.[39]

Soviet authors also frequently complain about the unfavourable balance and commodity composition of trade between the USSR and Canada. Increased Canadian importation of machinery and semi-processed goods from the USSR is the best way, in the Soviet view, to reduce their country's huge trade deficit with Canada. The Soviet remedy to the trade imbalance issue has faced a number of obstacles including underlying Canadian-Soviet competition in the production of many commodities, certain non-tariff barriers (such as Canadian anti-dumping regulations), the limitations of Soviet marketing strategies abroad,[40] and a traditional Western non-receptivity toward Soviet goods.

A different solution to the USSR's trade deficit with Canada was suggested by the Canadian historian J. Firestone during a visit to the Institute of the United States and Canada--namely, greater Soviet exports of raw materials and energy sources to Canada. Firestone argued that it would not be realistic to rely mainly on the growth of Soviet manufactured products in order to reduce the Soviet trade gap over the next several decades. The Institute politely published these and other remarks by Firestone, editorally adding however that the USSR does trade in raw materials and energy sources but:

> as a developed industrial nation is naturally striving to expand its exports of finished items in its relations with Western states which reflects an objective tendency toward the increasing role of the processing industry in worldwide economic ties and in the international division of labour.[41]

Although the Soviets are perennially hopeful about increasing their exports of manufactured goods to Canada, they are far less sanguine about Canadian efforts to diversify exports to the USSR. A statement by a Soviet trade official involved in negotiations with Canada (as executive secretary of the delegation to the Soviet-Canadian Mixed Commission on Economic, Industrial, Scientific and Technical Co-operation) reveals some of the practical and "interperceptual" difficulties affecting the developing of trade:

> as the Canadian business community gains a better knowledge of the progress made in Soviet engineering it becomes more interested in buying equipment and technologies from the Soviet Union. . . . Over the 1975-1977 period the Soviet Union exported machinery and equipment to the amount of 85.3 million rubles as against 8.5 million rubles in the preceding three year span. . . . Over the same period (1975- 1977) Canadian companies had received possibilities for Soviet orders worth several times the value of the contracts that were actually concluded. This situation is explained by the fact that Canadian firms' bids in response to Soviet orders for complete plant, sometimes were not sufficiently competitive and in a number of cases were inferior to those of other Western companies in technical and commercial indicators. . . . It seems that some Canadian businessmen, lacking sufficient experience in trade with socialist countries, have misconceptions regarding the position of Soviet foreign trade organizations, which lead to their overestimation of this country's interest in the purchase of Canadian equipment.[42]

The overall Soviet image of Canada as a trading partner appears to be a mixture of diplomatic optimism about the potential for growth and co-operation--particularly with respect to future Soviet exports of manufactured commodities--and hard-boiled realism about the limitations and problems hindering a rapid expansion and diversification of trade. Ironically, it is the most visible and significant sector of Soviet-Canadian trade--namely agricultural exports to the USSR--that has received the least attention in the accessible writings of Soviet Canadianists. Although Soviet authors publicly concede that the "lion's share" of their country's trade with Canada is made up of grain purchases, almost nothing is said about the bases, mechanics, fluctuations and long-term prospects of such trade.

The few studies concentrating on Canadian agricultural exports have focused on bilateral Canadian-US trade and some historical and internal problems concerning grain production and exports, with little explicit and no detailed mention of how Soviet imports might relate to these questions.[43] One obvious reason for this glaring omission is the Soviet Union's sensitivity about its need to import large quantities of grain from the capitalist world during the last two decades. Thus, Soviet authors usually explain such massive grain imports by reference to unfortunate weather, convenience of location and temporary structural difficulties[44] (all relevant factors, but only a portion of the whole story), while also maintaining the USSR's essential invulnerability to political manipulation of the international grain market by the West.

The Soviet officials' sensitivity and public reticence about the dimensions of their country's agricultural dependence is sometimes reciprocated by Canadian officials who simply consider it enterprising to draw attention to other areas of trade with the USSR. An interesting example of this occurred during the visit of Ivan Head to Moscow in the fall of 1977. At the time Head was a personal advisor to Prime Minister Trudeau on foreign relations. Head's comments made at the Institute of the USA and Canada focused on persistent problems with the commodity mixture of Soviet-Canadian trade and the special advantages that co-operation with Canada, rather than the United States, offers to the USSR:

> One of the areas of increased mutual cooperation is naturally trade. It was just a comparatively short time ago that one product prevailed in this area--the wheat exported by Canada. We hoped to diversify our exports to the Soviet Union, to include industrial goods with a high technological content. We also understood that our trade should ultimately become balanced since otherwise, it would not be of value to both partners. . . . we now have a much better idea of the kinds of commodities each of us produces and can offer to its trade partner. Besides this, in May 1975, the Canadian Government granted the USSR government commercial credit in the amount of 500 million dollars. In this connection I would like to stress the fact that we extended this credit at a time when the US Congress placed limits on the crediting of American-Soviet trade. A limit of 50 million dollars a year. In other words,

> Canada, which is approximately one tenth as rich as the United States, offered ten times as much credit to the Soviet Union.[45]

Head's further remarks in response to a question concerning Canada's attitude toward the policy of détente illustrate the reliable image that the Canadian side wished to project to Soviet official circles:

> The Canadians do not believe in any other policy, but the policy of détente. . . . Canada has never had colonies. Because of our geographic position and good luck, our territory has never actually been threatened with aggressive actions by anyone. The Canadians have no reason to dislike anyone because of his past or present, just as no one has any reason to dislike the Canadians for anything they have done or are doing.[46]

Only two years after these remarks were made in Moscow, Canada's friendly reputation and dependability as a trading partner of the USSR faced its first major test, as did the vigour of East-West détente.

The Afghanistan Sanctions and Canadian-Soviet Trade

The Western reaction to the Soviet invasion of Afghanistan at the end of 1979 had both an immediate impact and what appears to be emerging as a more lasting influence on the course of Soviet-Canadian relations. This section of the paper will survey briefly Canadian-Soviet economic relations in the 1979-1983 period as well as some of Moscow's changing perceptions towards Canada and other major agricultural trading partners of the USSR.

In early January 1980, the Progressive Conservative government of Joe Clark took a number of steps to protest the Soviet invasion of Afghanistan. Clark announced that, in addition to denying official recognition to the new regime in Kabul, Canada would cut off approximately $3.1 million in funds for two aid projects to Afghanistan and recall the small contingent of Canadian personnel working there. Other measures included a letter from the Prime Minister to Soviet President Brezhnev expressing disapproval with the invasion, the cancellation or restriction of all forthcoming visits to the Soviet Union by Canadian officials and scientific and cultural exchanges with the

USSR,[47] and a postponement of other plans for broadening Soviet-Canadian co-operation (e.g. extra Aeroflot flights to Canada, joint oceanographic research, etc.). Clark also questioned the appropriateness of holding the Summer Olympics in Moscow and offered to take the lead in considering other sites for the event. It was decided later that, because the Soviets failed to withdraw their troops from Afghanistan (they were offered a 20 February 1980 deadline), Canada would not send an official team to the Olympics (the government eventually paid the Canadian Olympic Association $1.2 million for costs involved in this boycott).

The most tangible and serious Canadian response to the invasion, however, was the Clark government's decision to join the US-led partial embargo of grain sales to the USSR. At a 12 January 1980 conference of grain exporters in Washington, Canada, Australia and the European Community agreed not to supply the Soviet Union with the grain that was to be denied them by the United States. Grain sales to the USSR by Canada and these countries were only to be continued at "normal" and "traditional" levels. The duration of the agreement was not specified but one US official characterized it as "not permanent, but indefinite," or what he understood to mean "something that runs off into the future, but gets fuzzier as you get into the future."[48] Argentina simply indicated at the conference that it would not "take trade advantages from the international situation." According to interpretations offered months later, the US had also agreed not to increase exports to the traditional customers of the other grain-exporting countries.

In Ottawa, a pledge was also made to compensate Canadian grain producers for any loss in income attributable to limitations on grain shipments to the USSR (in June 1981 payments totalling $81 million were made to farmers to cover the 4 January-31 July 1980 period. The Clark government also declared that Canada would work with the other Western industrial exporters to limit any further shipments of strategic and high-technology goods to the Soviet Union and would not renegotiate additional export credits with that country.

In practice, the Western economic measures taken against the USSR over Afghanistan exhibited neither the co-ordination nor the consequences that were intended. Despite the brave post-invasion rhetoric promising "concerted action" by the major grain exporters to sanction the USSR, grain shipments to the Soviet Union by these countries continued at a very substantial level.[49] The evidence indicates that US competitors increased their exports of grain to the USSR dramatically (see Table 3). Ignoring its pledges (which were rather vague in any case), Argentina took the greatest advantage of the situation by becoming the largest supplier of grain to the Soviet Union in the 1980-1981 crop year. Sales by Australia and the EEC countries also exceeded traditional levels of grain exports to the Soviet Union. In the Canadian case, the formula requiring "normal" and "traditional" levels of grain exports was interpreted loosely enough to allow for significant increases in grain sales to the USSR. Thus, Canada limited grain sales to the Soviet Union to 3.8 million tonnes for the 12 months ending 31 July 1980, but expanded sales rapidly at the beginning of the next crop year. In 1980-1981, the USSR remained Canada's largest market for grain exports (28.3 per cent of all Canadian grain exported), an increase of 62 per cent from the 1979-1980 crop year. Even the United States, which cut back by about half its planned grain exports to the USSR during the 16 months that Washington maintained its embargo, still permitted the sale of eight million metric tonnes of wheat and corn in accordance with the provisions of the 1975 US-USSR grain agreement. This placed the United States second to Argentina as a supplier of grain to the Soviet Union in 1980-1981. The USSR's importation of grain was considerably disrupted by the embargo--with a certain cost to their "food processing" operations--but as a result of increased grain sales by US competitors, and to a lesser extent the illegal trans-shipments of US grain by other countries, the Soviets were able to obtain most of the grain they needed without suffering any critical consequences.[50]

Beyond demonstrating the general weakness of food as a political weapon in foreign policy (a separate and complex issue that goes beyond the scope of this paper), the Afghanistan sanctions resulted in some major consequences for Canadian trade and foreign policy. First, the experience with the 1980 grain suspension experience considerably increased Canadian-US rivalry in approaching economic relations with the USSR, and thereby also lessened the potential for Canadian participation in any future co-operative ventures by Western nations to deal with aggressive Soviet international behaviour. Thus, from the very beginning of the 1980 embargo, Canadians were concerned about having become committed to a poorly-conceived US policy initiative with little hope of success. A number of important reservations concerning the embargo were raised: Canada's reputation as a reliable supplier of agricultural products to one of its principal markets might suffer irreparable harm; non-embargoing grain exporters such as Argentina were left free to stake out a larger share of the Soviet market; and the United States, despite vague promises to the contrary, might invade traditional Canadian markets with portions of the huge agricultural surpluses not being shipped to the USSR.

Returning to power in March 1980, the Liberals agreed to maintain the embargo but the failure of the sanctions to alter Soviet policy, together with increased evidence that the USSR was obtaining grain from other countries, seriously eroded support for a continuation of the existing policy. Ottawa also faced mounting pressure in mid-1980 from Canadian grain producers because of the limitations on sales to the USSR, growing agricultural surpluses and the related decline in grain prices.[51] The general disenchantment with the embargo in business circles was clearly expressed to a House of Commons sub-committee in October 1980 by one Canadian executive from a major company dealing with the Soviet Union:

> We in Canada seem to be very quick to espouse causes relating to imposing sanctions, embargoes, and that sort of thing, and sadly, we are very slow to get off the bandwagon. . . . I do not think sanctions work. Someone always finds a way around them and not only that, my own experience in supplying the equipment for the petroleum industry is that for some punishment of something that has been done wrong politically by the Soviet Union, our giant neighbor to the South will say, well okay, no more of this type of equipment. . . . We follow and some of the other NATO countries follow but pretty soon we get countries

> that have a much more intricate commercial relationship with the Soviet Union. . . . We find them breaking ranks and making a deal and then the eventual thing is that you see the American industrial sector pressuring their government to do the same thing, and finally Canada follows suit. Meanwhile we have lost these sales to other people.[52]

The advent of large Canadian grain shipments to the USSR at the beginning of the 1980-1981 crop year revealed a shift in policy that made continued Canadian adherence to the trade sanctions primarily symbolic. Official Canadian frustration with the embargo facade reached a climax in the fall of 1980 when it was announced that the United States had concluded a major grain agreement with China, in what Ottawa regarded as a blatant US effort to undercut an important and growing Canadian market. Within two days of the Sino-American agreement, Senator Hazen Argue, Minister of State for the Canadian Wheat Board, declared that the Clark government's policy of limiting grain sales to the USSR had been a mistake and that, in the future, Canada would sell the USSR as much as five million metric tonnes of grain, depending on grain availability. At the end of November 1980, Canada formally dropped its trade sanctions against the USSR. By early 1982, when discussions arose about using another grain embargo against Poland and the Soviet Union after Warsaw's declaration of martial law, Senator Argue referred to Canada's association with the US-inspired 1980 sanctions as a model mistake. Argue stated, "Canada went in and we were hurt. I don't see an embargo in the offing. . . . Food weapons aren't an effective weapon in international diplomacy and should be avoided."[53]

Canada's rebound from the experience of the Afghanistan sanctions also contributed to a marked expansion of Canadian grain trade with the USSR. In May 1981, Ottawa assured Moscow of future grain deliveries by signing a five-year agreement with the USSR calling for Canada to supply them with 25 million tonnes each of wheat, wheat flour, barley and oats through 1986. This multibillion dollar deal--Ottawa's first long-term arrangement with the Soviets in 12 years and the largest ever with one customer--was accompanied by apparently secret assurances that Canada would refrain from any further attempt to politically interfere with grain sales to the USSR. Although Senator Argue as head of the Canadian Wheat Board denied any commitment that no future embargoes be made to Moscow, he implied that there had been an exchange of letters to ease any Soviet worries about the prospect of a future suspension in grain deliveries:

> What the agreement is, is a contract, and there are assurances on both sides that everything will be done that can be done to fulfill the contract. . . . I'm not going to speak about any of the details of the negotiations that went on themselves. I'm just not going to make any reference to those kinds of things.[54]

Canada and the Soviet Union also established a mixed Commission on Co-operation in the Sphere of Agriculture, which had its first meeting in Ottawa in October 1982.

It is not accidental that the 1981 Canadian-Soviet grain agreement followed very shortly upon the Reagan Administration's decision to drop the Afgahanistan grain sanctions. In fact, by the middle of 1981, the United States was already waging a vigorous public campaign to convince Moscow that, at least with regard to the grain trade, the Carter years were over and it was going to be business as usual. For example, on 1 June 1981, just after the new Canadian-Soviet agreement, US Secretary of Agriculture John Block stated that "the US needs to be seen as a reliable supplier" and that trading partners will not soon forget the Carter embargo. Trade embargoes, he said, will be imposed only for "the most extreme circumstances" and then only as "total embargoes" rather than restrictions aimed at food supplies.[55] When asked two weeks later if the United States should embargo the Soviet Union if that country were to invade Poland, Block declared: "Should that unhappy event come to pass there will be a problem with supply from a lot of countries. . .and Canada might be one of them. I don't think the United States would be looking to act unilaterally."[56] The following year, announcing an extension of the US-Soviet agreement on grain purchases, Block urged US farmers to "continue building this important market, which was thrown away to our competitors during the partial embargo."[57] By the fall of 1982, President Reagan was able to assure

US farmers (on the eve of mid-term congressional elections) that the Soviet Union would enjoy "contract sanctity" for up to 180 days for any grain purchased from the United States and reiterated his earlier pledge not to "single out farm exports as a tool of foreign policy."[58]

In the wake of the Afghanistan sanctions, the surfeit of Canadian and US assurances about non-interference, reliability and "contract sanctity" in regard to grain supply provoked a certain amount of satisfaction in Moscow about the failure of the Carter-Clark embargo policies. Soviet commentators had, of course, always maintained that the USSR would not capitulate to "trade blackmail" and the "notorious policy of sanctions" designed to influence their country. Western assertions about the weakness of agriculture in the USSR and Soviet vulnerability to the use of "food power" are frequently denied by Soviet authors, who remind their readers that large imports of grain are "normal practice" especially for large countries with long-distance transportation problems. The USSR not only exports grain and has "sufficient grain reserves to guarantee the Soviet people constant supply of bread and baked goods" as one Soviet specialist at the Institute of the USA and Canada stated, but is also much stronger to resist trade boycotts than in past years because of "mutually beneficial trade with 131 countries."[59] In this regard, the same Soviet writer offered a coolly-pragmatic analysis of both Canadian and US motives in recent trade policy toward one another and the USSR:

> By forcing other Western countries to join it in restricting the grain trade with the USSR, the United States expected to undermine their commercial operations in the Soviet market and thereby inflict injury on them. Canada, Australia and the EEC countries understood Washington's maneuver perfectly and categorically refused to support US policy in this area. . . . Without concealing their satisfaction with the United States' self-isolation from the Soviet market, its rivals took advantage of the situation to expand sales of grain to the Soviet Union. . . . For this purpose they used the record level of past years to signify the 'usual' and 'traditional' quantities of grain shipments. Furthermore, as far as Canada and Australia were concerned, the signing of a grain trade agreement in October 1980 by the United States and China gave Ottawa and Canberra an excuse to officially disassociate themselves from the American embargo.[60]

Assessments by Soviet observers of their country's position in international economic relations are not, however, limited to optimistic commentaries about the failure of the Western grain embargo. For one thing the Soviets have been faced with vigorous, if largely unsuccessful, efforts by the Reagan Administration to limit the flow of important non-agricultural products to the USSR. Moreover, whatever the Soviets' degree of vulnerability to the use of food power may actually be, the fact remains that the USSR continues to depend upon large imports of Western grain (a requirement that intensified after 1978 due to a succession of bad harvests).[61] While the costs of economic interdependence--including the food issue--have received close attention in Moscow since at least the twilight of the Brezhnev era, it seems unlikely that the Soviets can quickly avoid their dependence on agricultural imports from the West. Even a modest level of political disruption to the grain market is, therefore, something the Soviet leaders wish to avoid whenever possible.

Having experienced the difficulties and inconvenience caused by the Afghanistan sanctions, but still unable or unwilling to reduce grain imports, Soviet policy-makers have decided to avoid over-dependence on the US for agricultural products. Thus, in addition to the recent five-year grain agreement with Canada, the USSR has negotiated long-term commodity agreements with Argentina (4.5 million tonnes of coarse grain and soybeans annually, 1981-1985), Brazil (soybeans and corn, 1982-1988), New Zealand (butter and whole milk powder, 1982-1985), Sweden (butter, 1982-1985), Thailand (rice, corn and tapioca, 1981-1990) and Hungary, Eastern Europe's top agricultural exporter (500,000 tonnes of wheat and corn annually, 1981-1985).[62] As far as grain is concerned, Canada and Argentina have been the major beneficiaries of this shift in policy and the United States the major loser. For example, by the end of March 1983, US sales of grain accounted for only 6 million of the 27 million tonnes the USSR purchased for the year ending 30 September 1983, or barely 22 per cent of the Soviet market. Prior to the Afghanistan grain suspension, the United States typically had 60 per cent to 70 per cent of total Soviet purchases. The new pattern of Soviet grain imports is clearly designed to countersanction Washington for its past and current restriction on trade with the USSR. A Soviet foreign trade official commented: "In dealing with the United States difficulties with dependability of supply had contributed to lower levels of total imports and a slow down in programs for grain utilization."[63] Soviet grain purchases from Argentina during 1982 and early 1983 were roughly equivalent to those made from the US while, for the first time in a decade, during a period without an embargo, Canada surpassed the United States as a grain supplier to the USSR. At least in the area of grain sales, it seemed that Canadian trade significantly benefited from Ottawa's prescient decision to leap off the US embargo "bandwagon".

Canada in the Kremlin's Calculus: A "Reliable" Trading Partner

The decade after 1971 witnessed a considerable expansion in Soviet concern and co-operation with Canada. Both the achievements recorded during détente and the difficult adjustments caused by new East-West tensions after 1979 contributed to more realism and mutual understanding between Canada and the USSR. Moscow's decision to vigorously expand and exploit political and economic relations with capitalist countries other than the United States fostered Soviet assessments of Canada that were more informed, varied and sophisticated than in the years before détente. The simplistic image of Canada as essentially a US dependency was largely discarded, as Soviet writers turned their attention to such topics as the prospects for increased trade with Canada, the complex dynamics of the US-Canadian relationship, as well as many other interesting facets of Canadian society. The emergence of a small, but prolific, group of Canadianists at one of Moscow's most important "think-tanks" for the study of international relations supported this heightened awareness of Canada in the USSR. On the Canadian side there has been a sober-minded view of the motivation and limits of recent Soviet attention to Canada and what the response to it should be. As Robert Ford, the former Canadian Ambassador to Moscow (1964-1980), recently remarked:

> Washington est manifestement le foyer d'attention des Soviétiques en Amérique du Nord. Le Canada joue inévitablement un rôle secondaire dans la philosophie du Kremlin. Lorsque les relations avec Washington sont bonnes, les Soviétiques négligent Ottawa. Lorsque les relations sont tendues, leur intérêt pour Ottawa ravive. . . . Les Soviétiques affirment assez souvent aux représentants canadiens qu'ils sous-estiment leur influence dans les affaires mondiales. Je ne crois pas que ce soit vrai, mais nous savons reconnaître les limites d'une action authentiquement indépendante dans les relations Est-Quest.[64]

Similarly, in the areas of trade between Canada and the USSR, the euphoria and sometimes rather simplistic expectations present on both sides during the early 1970s have been replaced by greater appreciation of the practical difficulties and obstacles that are involved. Although each country seeks to sell the other more manufactured products, it seems unlikely that this sector of Soviet-Canadian trade will undergo more than modest growth in the near future.[65] Agricultural trade remains the prime component of Canada's economic relations with the USSR, a situation that seems destined to continue and prosper in the wake of the failed Afghanistan sanctions, and Moscow's related decision to diversify its sources of grain supply. Thus, despite the expression of serious reservations in the USSR about continuing large-scale imports from the capitalist world, the Soviets appear neither capable nor desirous of abandoning or radically altering the policy of economic interdependence adopted in the 1960s and 1970s. As a result of various economic constraints and political liabilities, the Soviet decision-makers are simply being far more careful and selective in approaching their trading relationship with Western countries.[66] In this context, the Kremlin's present evaluation of Canada as a relatively dependable and useful alternative to overdependence on the United States, offers the best prospect for further improvement and momentum in Soviet-Canadian trade during the 1980s.

Epilogue: Trade Progress, Prudent Sanctions and a Peace Shuttle

By the spring of 1983, Soviet-Canadian political and economic relations had undergone a marked improvement as both countries endeavoured to eliminate the adverse consequences of the "Afghanistan sanctions". The continued chill in Soviet-US relations, caused in large part by Washington's expanded use of economic embargoes against the USSR (but excluding grain after April 1981), enhanced Moscow's perception of Canada as a reliable and only moderately-politicized trading partner. In 1982-83, as in the previous four crop years, the Soviet Union was Canada's largest annual supplier of grain to the USSR with record sales of close to nine million tonnes valued at about $15 billion. The volume of Canadian grain exports to the USSR slightly exceeded sales by Argentina, with the United States in third place.

Canadian government experts on trade with the USSR were also optimistic about the potential for increasing sales of non-grain products to the Soviet Union, particularly in the area of oil and gas machinery as well as equipment associated with agribusiness (exports in these particular areas picked up noticeably during the period from January to June 1983 even though total sales declined by 7 per cent for that period compared to 1982, and the equivalent figure for imports from the USSR dropped by 42.3 per cent). In the view of Canadian officials, the continued use of sanctions against the USSR by the Reagan Administration offered a "matchless opportunity to fill the vacuum created by the absence of some American products."[67] Important obstacles to better Soviet-Canadian relations still existed such as difficulties surrounding the negotiations of a new cultural and scientific exchange agreement between the two countries,[68] and residual aspects of the troublesome Polish question, but the general attitude in both Moscow and Ottawa was rather upbeat (especially relative to US-Soviet relations).

The May visit to Canada by a six-member Soviet delegation headed by Politburo member Mikhail Gorbachev signalled the importance that the Kremlin attached to the normalization of trade ties with Canada. In June, Gerald Regan, the Canadian Minister of

State for International Trade, led a delegation to Moscow for the Third Canada-USSR Mixed Economic Commission (MEC), the first meeting of this body since before the invasion of Afghanistan. While the exchange of visits did not result in a major expansion of trade, there was general agreement on both the Canadian and Soviet sides to aggressively promote expanded commercial ties (through the MEC Working Groups, increased contacts between Canadian businessmen and Soviet officials, etc.). During the MEC discussions in Moscow, the Soviet Deputy Minister of Foreign Trade, Vladimir Sushkov, was said to have expressed satisfaction over Canada's "realistic stand" on trade issues, an apparent contrast to Washington's "ideological approach" to foreign economic relations.[69] As in past Soviet-Canadian discussions, great stress was placed on the need for trade diversification which would allow both sides to expand their sales of industrial export products. Unfortunately there was little evidence of any real solutions to the fundamental economic issues and problems of mutual perception (see above) that had obstructed any significant growth in non-agricultural trade. Whatever the prospects for trade might be, however, Ottawa was determined that a reimposition of politically motivated sanctions would not again be allowed to seriously disrupt commercial relations with the USSR. A report of Canadian trade policy for the 1980s prepared in the summer of 1982 and published in August 1983, stressed the limitations and dangers forced by a country that employs sanctions or embargoes:

> Sanctions whether complete or partial are perceived to be the most potent measure in a nation's foreign policy arsenal, short of war, to indicate disapproval of another nation's policies or practices. . . . In practice, however, it has proven to be a form of economic warfare. . . . When imposing sanctions, whether limited or general, it is important to consider their purpose. If it is to convince the regime against which the sanctions are to be imposed to change its policies or practices, such results have historically been rarely achieved. Broadly conceived sanctions of this kind usually hurt innocent parties more severely than the intended regime--i.e., either the citizens of the country against which the sanctions are to be imposed or Canadian exporters and manufacturers.[70]

The conclusion of a new long-term Grain Pact between the Soviet Union and the United States in July 1983 (to take effect 1 October 1983) was a potentially ominous development for Canada's improved position as a reliable Soviet trade partner. The five-year pact which provides for Soviet purchases of from nine million to 12 million tonnes of wheat and corn annually from the US was designed by Washington to recover the dominant share of the Soviet grain market.[71] For Moscow, the pact had a number of distinct advantages. It formulated the restocking of the Soviet Union's badly-depleted grain stocks, served as a gesture encouraging improved Soviet-US relations, reduced the likelihood of a future US grain embargo, and guaranteed even in the event of such an embargo the USSR would still have the right to purchase up to 12 million tonnes of grain a year.

The Canadian reaction to the new Soviet-US pact was initially very low-key with most spokesmen for Canadian farm groups suggesting that the agreement would actually boost the price of grain sold by Canadian farmers.[72] Moreover, it was argued that in view of Moscow's success in diversifying its foreign sources of grain supply after the 1980 embargo episode, the new pact did not necessarily mean that Soviet purchases from the United States would immediately rebound to the high pre-embargo levels. The more important problem for Canada and other Soviet grain suppliers, however, is what might happen when their own long-term grain pacts with the USSR expire two years or more before the termination of the new US-Soviet agreement. At this point, with Moscow enjoying guaranteed imports of 12 million tonnes from the United States, the Soviet leaders might be reluctant to negotiate new agreements such as those currently pledging them to large-size purchases from Canada (five million tonnes), Argentina (four-and-a-half million tonnes) and other countries. When this possibility is added to growing Soviet efforts to improve their own agricultural production, the future of the USSR as a stable and growing customer for Canadian grain becomes somewhat questionable.[73]

The routine undercurrent of spirited commercial competition between the two North American NATO allies for trade with the USSR was temporarily overshadowed by their shared sense of indignation over the Soviet destruction of a civilian Korean airliner on 1 September 1983 that resulted in a loss of both Canadian and US lives. When Moscow refused to take responsibility for the downing of the airliner, Ottawa retaliated against the USSR by banning all Aeroflot flights into Canada for a 60-day period. Non-governmental Canadian reaction to the airliner incident, although somewhat disruptive to the previously improving climate in relations with the Soviet Union, was also limited in nature even if it did take some bizarre forms--for example, the cancellation of an ongoing visit by the Soviet circus troupe, the destruction of a Lada automobile by a group of outraged Canadian workers, and the publicly-announced decision by a British Columbia cabinet minister to return a Lada to the dealership that had loaned it to him.[74] A similar mixture of grief, non-economic sanctions and often hyperbolic indignation characterized the US response to the downing of KAL 007, although the Reagan administration departed from Ottawa's response by using the incident to present a sweeping indictment, particularly in contrast to the situation after the invasion of Afghanistan. The use of economic sanctions against the USSR is now regarded by Canada, the United States and the other Western allies as an essentially ineffective and counterproductive course of action that ought to be avoided whenever possible. Politically under domestic pressure to normalize and expand their respective shares of the lucrative Soviet market, and also genuinely fearing the dangers inherent in a serious East-West confrontation, Western leaders have become reluctant to go beyond the use of largely symbolic sanctions as a means to chasten the unacceptable activity to their powerful ideological adversary (the US response to activities by Soviet surrogates in Central America, the Caribbean or the Middle East is another matter). When prodded in the House of Commons to take stronger measures to elicit an acceptable explanation from Moscow about the KAL 007 incident, Prime Minister Trudeau expressed a widely held view in the Western alliance that the maintenance of non-rancorous dialogue and commercial relations with the Soviet Union is the only way, if any, to influence Moscow's foreign policy choices:

> What do we do now?. . . Do we go on shouting, or do we start a war, or do we tell the western farmers that they should not sell their wheat to the Soviet Union?. . . for about one month we expressed our indignation and outrage. I repeat that the Government has taken the lead in doing that, and it was in the forefront of all the nations of the world. Now what did it get us and where are we?. . . I ask the Leader of the Opposition, does he want to send a gunboat to shell Leningrad, or what?. . . I can express indignation just as well as the Leader of the Opposition. . . . Now I think that there should be some effort to re-establish communications with the Soviets. I, for one, think that it is in that direction that the superpowers must go.[75]

On 6 November 1983, the two-month ban on Aeroflot flights to Canada was lifted, although Ottawa continued to demand a complete explanation from the Soviet Union about the airliner downing and also compensation for the families of victims. Canadian relations with the USSR which had only been slightly disrupted during the modest ban on Soviet flights, now returned to normal. By the latter part of 1983, events in the eastern Caribbean and elsewhere had largely eroded, if not completely erased, the jarring emotional impact of the KAL disaster on world public opinion. Frustrated by the continued deterioration of US-Soviet relations and the apparently-stalled Geneva arms control negotiations, Prime Minister Trudeau decided to offer his own ideas and mediation efforts to improve the situation. As he put it: "East-West relations are too important to be left to the superpowers alone."[76] How this brand of personalized diplomacy by the leader of a middle-sized power will affect the climate of international relations, and the course of future Canadian-Soviet relations in particular, remains to be seen.

Notes

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11. Abram Bergson, "Soviet Economic Slowdown and the 1981-85 Plan", Problems of Communism 30 (No. 3 1981): 24-36 at 27; The New York Times, (28 January 1983), D1.
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23. Philip Hanson, "A Backlash Against Technological Imports?" Radio Liberty Research Bulletin, RL 453/81 (12 November 1981): 1-6.
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27. Erik P. Hoffmann and Robbin F. Laird, The Politics of Economic Modernization in the Soviet Union (Ithaca, N.Y.: Cornell University Press, 1982), 159-75.
28. Kravalis, "USSR", 307.
29. L.A. Bagramov and V.B. Povolotsky, "Cooperation with Canada: Potentialities and Prospects", SShA: Ekonomika, Politika, Ideologiya (No. 12 1977): 30-42. (This journal is published in Russian and is hereafter cited as SShA and, as here, with only

the English translation of Russian titles.)

30. M.M. Kostecki, "Canada's Grain Trade with the Soviet Union and China" in Canadian Journal of Agricultural Economics 30 (No. 2 1982): 223-38 at 226.

31. Dr. Leon Bagramov has headed the Canadian Section Department since 1974 and he may have been chief of an unspecified section at the Institute studying Canada since 1972. In the 1970s, the Institute grew from about 70 to 450 members. The main task of the Institute is to prepare reports for the International Department of the Party Central Committee, the Ministry of Foreign Affairs and the KGB. Such Institute reports frequently form "the core" of journal articles in USA: Economics, Politics, Ideology, which has a circulation of about 35,000 copies, including 2,000 subscribers in foreign countries. The Institute also publishes about a dozen books a year. An important role of the Institute, as Adam Ulam points out, has been to sell détente through a "new-style public relations campaign aimed at influencing 'respectable' circles abroad: businessmen, intellectuals, the media community"; Adam Ulam, Dangerous Relations, the Soviet Union in World Politics, 1970-1982 (New York: Oxford University Press, 1983), 133. The international composition and operation of the Institute are discussed in Steven Grant, Soviet Americanists (Washington: Office of Research, US International Communications Agency, 1980; Supplement, August 1982) and Barbara A. Dash, A Defector Reports: The Institute of the USA and Canada (Washington: Delphic Associates, 1982). A study of the Institute's Canadian Department (which is not treated in the two previous works) is currently in preparation by Lenard Cohen.

32. Oded Eran, The Mezhdunarodniki: An Assessment of Professional Expertise in the Making of Soviet Foreign Policy (Ramat Gan, Israel: Turtledov Publishing, 1979), 98-101.

33. David Wagner, "Recent Soviet Works on Canada" in The American Review of Canadian Studies 12 (No. 3 1982): 99-105 at 105. For a general survey of Soviet perspectives on Canada

see William McGrath, "Recent Soviet Images of Canada and International Politics" in Canadian-Soviet Relations 1939-1980, edited by Aloysius Balawyder, 193-207, and "Canada in the Soviet Mirror" in Canada in World Perspective, edited by S.D. Stairs and D. Munton. (forthcoming)

34. For the changing Soviet perception of US-Canadian relations compare S.S. Dimitriev, "American Capital and the Canadian Economy", SShA (No. 10 1970): 81-3; V.S. Guseva, "American-Canadian Contradictions", SShA (No. 7 1972): 49-51; B.I. Alekhin, "US Capital in Canada: A New Phase", SShA (No. 11 1973): 28-40; L.A. Bagramov, "Canada-US: Conflict of Interests", SShA (No. 2 1974): 39-53; T.V. Lavrovskaya, "Intergration Processes in North America: The General and the Specific", SShA (No. 3 1978): 28-42; and V. Popov, "Canada-USA: Uneasy Partnership", International Affairs 9 (1982): 84-92. There are also more specialized articles on this question such as V.B. Povolotsky, "The Canadian-American Autopact", SShA (No. 5 1973): 58-64; L.N. Karpov and L.V. Smiryagin, "US and Canadian Energy Policy", SShA (No. 6 1975): 42-55; V.D. Pisarev and M.P. Krasnov, "American-Canadian Rivalry in the Development of Ocean Resources", SShA (No. 7 1980): pp. 89-98; V.E. Shilo, "Canada's Provinces and the US", SShA (No. 9 1980): 118-27 and S. Molochkov, V.B. Povolotsky et. al., Kanada-SShA: Ekonomicheskie i Politicheskie Otnosheniya (Moscow: Nauka, 1983).

35. See, for example, V.G. Milhaylov "Canada's Problems in the 1970s", SShA No. 7 1973): 34-46; S.F. Molochkov, "Canada's New Roles", SShA (No. 9 1973): 74-6; V.B. Povolotsky, "Canada in Search of New Markets", SShA (No. 11 1974): 37-48; L.A. Bagramov and V.V. Popov, "Some Distinctive Features of Canadian Economic Development", SShA (No. 9 1979): 33-47; and S.F. Molochkov, "Canadian Foreign Policy in the Seventies: The Third Alternative", SShA (No. 3 1979): 7-12.

36. L.A. Bagramov and V.B. Povolotsky, "Cooperation with Canada: Potentialities and Prospects", SShA (No. 12 1977): 30-42.

37. Ibid., at 40. It is interesting to compare Soviet evaluations with a recent Canadian study: "Other characteristics of the Canadian economy--the cautious, uncompetitive nature of its financial institutions, the decline of productivity, the weakness of competition legislation, and the reluctance of many small Canadian-owned firms to look beyond the familiar confines of North American markets--obviously had some bearing on the fate of the Third Option. But there is little doubt that the pattern of industrial structure flowing from foreign ownership was the major constraint". C.C. Pentland, "Domestic and External Dimensions of Economic Policy: Canada's Third Option" in Economic Issues and the Atlantic Community edited by Wolfram F. Hanrieder, pp. 156-57 (New York: Praeger for the Committee on Atlantic Studies, 1982).

38. Bagramov and Povolotsky, "Cooperation with Canada", 40-41. A year before, V.B. Povolotsky had surveyed the general trends in trade between the two countries: "Growing Soviet-Canadian Economic Cooperation", SShA (No. 10 1976): 65-71.

39. See also the essays in Kanada na poroge 80-kh godov: Ekonimika i politika, edited by L.A. Bagramov (Moscow: Nauka, 1979), and Kanada-SShA: Ekonomicheskie i Politicheskie Otnosheniya, edited by S.F. Molochkov, V.B. Povolotsky et al. (Moscow: Nauka, 1983). Although the number and range of Soviet studies on Canada has increased in recent years, the question of Canadian foreign trade has been receiving less explicit attention than in the late 1970s, possibly because of the difficulties affecting détente and East-West trade, especially after the invasion of Afghanistan (which will be discussed later in this section of the paper). In this regard, it is interesting that the Canadian Department at the Institute of the USA and Canada is currently (1983) preparing a monograph "Canada in World Trade". Many recent Soviet statements concerning Canada have naturally focused on the anti-nuclear movement and the cruise missile, or what one Soviet Canadianist called the "one field of Soviet-Canadian co-operation which may yield the most valuable

and desired results". S. Molochkov, "40th Anniversary of USSR-Canada Diplomatic Relations" in Soviet News and Views 13-14 (July 1982): 12. See also Nikolay Bragin, "In a Dangerous Harness", Pravda (15 February 1983): 5; and Ye. V. Israyelyan "The Anti-War Movement in Canada", SShA (No. 5 1983): 52-9.

40. Carl H. McMillan "Canada's Postwar Economic Relations with the USSR", 157-60. Soviet observers occasionally confess that the weak competitiveness of their own countries engineering exports stems from the low technological level of manufacture as well as a serious overestimation of the sophistication of Soviet products by their manufacturers, N. Smelyakov "I spros zavisit ot predlozheniya", Trud (24 July 1981), 2.

41. O.J. Firestone, "USSR-Canada: Potentialities for Broadening Bilateral Relations", SShA (No. 4 1979): 25-34 at 25. See also O.J. Firestone, "How to Cut Soviet Trade Gap", The Financial Post (18 November 1978): 42.

42. E. Balaban "A New Stage in the Development of Soviet Canadian Cooperation" Foreign Trade (Moscow), 2 (1979), 27-28. Some of the underlying problems of the Soviet-Canadian trade imbalance are discussed in Carl H. McMillan, Export Diversification: The Case of Canadian Trade with the USSR and Eastern Europe, (Ottawa: Institute of Soviet and East European Studies, Carleton University, 1981).

43. E.A. Shevliagina, "Canadian-American Trade in Farm Products", SShA (No. 11 1975): 122-7, and by the same author, "Canada: Some Problems of Grain Production and Exports", SShA (No. 4 1981): 91-101. Leon Bagramov, the Head of the Canadian Department at the Institute of the United States and Canada has published a number of articles on the food issue in international politics, but rarely refers to Canada in his work. In one 1977 article, he does mention, however, that the grain sales of Canada and other countries limit the effectiveness of the US "food weapon" (something the Soviets may have counted on when they invaded Afghanistan). "Food and Politics", International Affairs, (Moscow) (No. 6 1977): 45-53; see also Leon Bagramov, "Food

and Superprofits: Penetration of the Developing Countries by International Monopolies", International Affairs, (Moscow) (No. 2 1982): 52-60; and "Behind the Facade of Food Aid", Mirovaia ekonomika i mezhdunarodnye otnoshenia, No. 3, (March, 1982): 92-102.

44. Allen Kroncher "The Food Program and Soviet Agricultural Policy", (RFE/RL) Radio Liberty Research Bulletin, RL 324/82, (12 August 1982).

45. "Canadians for Détente", SShA (No. 10, 1977): 87-88.

46. Ibid., 89.

47. Soviet-Canadian cultural and scientific exchanges had grown quite considerably during the period of détente. In 1978 for example, 126 Soviet scientists went to Canada to take part in meetings or were invited for visits while 92 Canadian specialists visited the USSR. B.I. Aliokhin, "The USSR-Canada: Scientific and Technological Contacts", SShA (No. 12 1979): 115-7. The Canadian suspension of the General Exchange agreement after the Soviet intervention in Afghanistan resulted in the cancellation of planned visits for several hundred Canadians including 60 scientists, professors, and senior researchers; 245 students; several dozen artists and dancers; and approximately 12 non-Olympic sports teams. Negotiation of a new Canadian-Soviet exchange agreement has proceeded slowly because of Canadian concern that the results of pre-1980 scientific and technical exchanges were too one-sided. As one Canadian official remarked: "we were always trying to push cultural exchanges and they seemed interested mostly in hard sciences and engineering." Despite such reservations, Moscow and Ottawa have been discussing the possibility of a wide-ranging exchange program, including research on Arctic oil and gas exploration, a sector of co-operation which might elicit strong reaction from Washington. Fred Harrison "Canada, Soviets Study Exchange", The Financial Post (9 April 1983): 15.

48. John Pearce Hart, An Assessment of the Afghanistan Sanctions: Implications for Trade and Diplomacy in the 1980's: Report,

Prepared for the Subcommittee on Europe and the Middle East of the Committee on Foreign Affairs, US House of Representatives (Washington: US Government Printing Office, 1981).

49. It seems that US officials had only a fuzzy idea of the behaviour of other Western grain-exporting countries. On 4 June 1980, President Carter's Press Secretary, Jody Powell, felt sure that the EEC countries, Canada and Australia would co-operate with the US-led embargo, but in response to a question about Argentina claimed that "they don't count on these products". Carter himself thought Argentina had no grain on hand to replace US shipments to the USSR and that other countries "asked" to co-operate would do the same. John Roney has argued that there is no evidence that either Carter or other US officals consulted with officials of other grain-exporting countries prior to the embargo. "Grain Embargo as Diplomatic Lever: A Case Study of the US-Soviet Embargo of 1980-1981" in Soviet Economy in the 1980's: Problems and Prospects, Part II by the Joint Economic Committee, US Congress (Washington: US Govt. Printing Office, 1983), 131; and also Robert L. Paarlberg, "The 1980-1981 Grain Embargo: The Frustration of Power", a Paper delivered at the conference "The Utility of Economic Sanctions as a Policy Instrument", York University, 24-25 March 1983. The US government embargo policy was formulated on the basis of unrealistically low intelligence projections of grain supplies available to the Soviet Union and was also undermined by the fact that private US grain companies had shrewdly rerouted the declared destination of their grain shipments to the USSR in anticipation of a possible embargo. Richard Gilmore, A Poor Harvest: The Clash of Policies and Interests in the Grain Trade (New York: Longman, 1982), 167-8. A report by a committee of the European Parliament has criticized the European Commission for failing to prevent the "massive increase" of food product deliveries to the USSR by member countries during the embargo. European Parliament Working Documents, 1982-1983, Document 1-1003-82, (15

December 1982).

50. On the vulnerability of the USSR to Western sanctions of agricultural and non-agricultural products against the USSR, see (in addition to the sources cited in note 21) F.H. Sanderson, "Uses and Limitations of 'Food Power' ", a Paper presented to the Conference on "Agriculture and Foreign Policy", Spring Hill Center, Minneapolis, Minn. (29 April-1 May 1982); Roosa et al, East-West Trade at the Crossroads, 43-9, 83-9. Philip Hanson, "Western Economic Sanctions Against the USSR", a Paper presented to the NATO Economic Directorate Colloguium, Brussels, Belgium, (April 1983).

51. The Canadian Press (Datafile) News Wire Service Reports, derived from the Canadian Press NEWSTEX (CPN) a computerized data base of newspaper stores, hereafter cited in this study as CPN and followed by the dates of the reports.

52. House of Commons, Canada, Minutes of Proceedings and Evidence of the Sub-Committee on the Conference on Security and Cooperation in Europe (CSCE) in preparation for the Madrid Conference, Standing Committee on External Affairs and Natural Defence. Issue No. 8, (1 October 1980), 29-30.

53. CPN (26 February 1982). The 1980 Canadian embargo on high technology exports to the USSR and the withdrawal of export credits to Moscow continued despite the new policy on grain deliveries.

54. CPN (27 May 1981).

55. CPN (1 June 1981).

56. CPN (13 June 1981).

57. CPN (21 August 1982).

58. CPN (15 October 1982). In January 1983, US President Reagan agreed to sign legislation which would allow him to limit sales to foreign countries, but the limit would not affect agricultural exports covered by contracts calling for delivery within 270 days of the embargo announcement. The reason for adding this so-called sanctity of contract clause, Reagan remarked, was to "restore confidence in the United States' reliability as a

supplier". During the Carter embargo "other countries filled in the gap and then locked in new long-term trade agreements with the Soviets. . .we not only lost sales we lost our reputation as a reliable supplier. It takes years, not months, to regain that reputation." New York Times (12 January 1983), 1 and 9.

59. V.A. Yulin " 'Conditional Flexibility' in Trade with the USSR", SShA (No. 6 1980): 27-8. Introducing the new Soviet Food Program in May 1982, Brezhnev told a plenary session of the Central Committee "in recent years we have been compelled to buy grain, meat, and a number of other products abroad. This has been done in the interests of the people. In the future as well, we have no intention whatever of giving up what foreign trade can offer with respect to replenishing our food resources. . . . At the same time, as you know, the leadership of certain countries seeks to turn ordinary commercial operations--such as grain sales, for instance--into a means of pressure on our country. . . . We have never put up with this, and we have no intention of putting up with it (Applause). I think that the members of the CPSU Central Committee will support this statement of the question (Prolonged Applause). Current Digest of the Soviet Press, 34 (No. 21): 6.

60. V.A. Yulin, "New Fiasco of Trade Policy from the Position of Strength", SShA (No. 6 1981): 52-4 at 54.

61. Contrasting approaches and conclusions regarding Soviet agricultural production and food imports demand can be found in Joseph Hajda, "The Outlook for East-West Agricultural Trade" in East-West Relations: Prospects for the 1980s, edited by Giuseppe Schiavone (London: Macmillan, 1982): 47-58; Padma Desai, "Soviet Grain and Wheat Import Demands in 1981-85", American Journal of Agricultural Economics 64 (No. 2 1982): 312-22, and Marshall I. Goldman, USSR in Crisis: The Failure of an Economic System, chapter 3. Difficulties with grain production have become so serious that the USSR has opted to keep data on grain harvests a secret since 1980. It appears that the Soviet grain harvest in 1983 will be around 200 million

metric tonnes, an increase of about 20 million tonnes over the 1982 harvest. Despite the increase, US specialists estimate that the USSR will need to import 29 million tonnes of grain to meet all their needs. The New York Times (17 November 1983), 33.

62. Debra Henke, "Soviet Use Commodity Agreements to Protect Supplies", Foreign Agriculture (April 1982): 20-1.

63. New York Times (26 March 1983), p. 24.

64. "La Perception Canadienne des Relations Est-Ouest", Politique Internationale 12 (été 1981): 219 and 221. Elsewhere Ford has remarked "we have an interest in a civilized relationship with the USSR, which will continue to assure us of our major market for grains, above all wheat, and to improve the situation of the Russian, Ukranian, Baltic and Jewish peoples and of advocates of religious and democratic liberties, something all Canadians are concerned about, but in particular the large number who have cultural or ethnic ties with the Soviet Union." "Canada and East-West Relations", Spectrum 2 (No. 4 1982): 10.

65. On Canada's comparative advantage in the trade of resource-based products which could hinder the increased export of manufactured goods, see Christopher C. Beckman, "Canada's International Trade Performance: A Survey of Recent Trends", Executive Bulletin (Ottawa: The Conference Board of Canada) 23 (September 1982). On the commercial prospects of Canadian agricultural trade with the USSR, see R. da Costa, "The Soviet Union" in Agriculture Abroad 37 (No. 1 1982): 34-9.

66. On the broader implications of this trend see John P. Hardt and Kate S. Tomlinson, "Economic Factors in Soviet Foreign Policy", and Marshall I. Goldman, "Soviet East-West Trade: Can the Means Become the End?" in Soviet Foreign Policy in the 1980s, edited by Roger E. Kanet (New York: Praegar, 1982), at 37-57 and 247-59 respectively; Philip Hanson, "Foreign Economic Relations" in Soviet Policy for the 1980s edited by Archie Brown and Michael Kaser, 65-97 (London: Macmillan, 1982).

67. Interviews with members of the Commercial Section at the Canadian Embassy in Moscow, (May 1983).

68. See note 48 above. Visits by Canadian and Soviet cultural groups, scientists, and scholars to each others' country continued from 1980 to 1983 but only on an ad hoc, invitational basis. Interviews in Moscow (May 1983) indicate that support for a new exchange agreement to institutionalize such visits is as great among the small but energetic community of Soviet Canadianists, as it is among the larger and more pressure-group oriented Canadian slavists and sovietologists. As of mid-November 1983, Ottawa and Moscow had been unable to renegotiate a new exchange agreement.

69. CPN (3 June 1983).

70. A Review of Canadian Trade Policy: A Background Document to Canadian Trade Policy for the 1980s (Ottawa: External Affairs, 1983), 144-5.

71. For the discussions and positions on this matter in American governmental and economic circles see Economic Impact of Agricultural Embargoes, Hearings before the Subcommittee on Foreign Agricultural Policy, US Senate Committee on Agriculture, Nutrition and Forestry, 97th Congress, Second Session, (Washington: US Government Printing Office, 1982); John Hardt and Donna Gold, US Grain Sales to the USSR, Issue Brief 75070 (Washington: Library of Congress, Congressional Research Service, 1983); and John Hardt Long-Term Agreement (LTA): Some Considerations for Negotiations, Congressional Research Service, 27 April 1983. (mimeo)

72. Winnipeg Free Press (30 July 1983), 11; CPN (18 and 19 May 1983; 29 July 1983; 2 August 1983).

73. The election in November 1983 of a centrist-oriented civilian government may also enhance Argentina's attractiveness in Moscow as a more reliable and stable grain supplier. In late 1983, an escalation in Moscow's pressure on Canada to buy more from the USSR led to serious concern in Ottawa that Canada's long-term position as a preferred grain supplier to the Soviet Union might be threatened. When Canadian Wheat Board officials suggested that it might be a good idea for Prairie

farmers who sell so much grain to the USSR to purchase more Soviet-built cars, tractors, and combines, there were vocal objections from Canadian farm equipment manufacturers and their friends in Parliament. Financial Post (26 November 1983), 1 and 4; House of Commons Debates, Official Report (Hansard), 32nd Parliament, 1st Session, (25 November 1983), 29201-2. Soviet commentaries naturally ignore the possible loss of Canadian jobs as a result of increased imports from the USSR, stressing instead the Canadian employment created by sales to the Soviet Union. "Soviet Purchase Saves Saskatchewan Village", Soviet News and Views 4 (February 1983): 16; "Soviet-Canadian Commission Resumes Work", Soviet News and Views 4 (August 1983): 1.

74. On September 21, the Canadian media revealed that ten days earlier two Soviet diplomats were expelled from Canada for attempting to steal top secret high technology. External Affairs Minister Allan MacEachen deliberately withheld news of the expulsion to avoid complicating the Korean Air Lines incident. Mr. MacEachen felt it was wise in this particular instance "to avoid a linkage and to avoid any possible use of this case to invite retaliation directed at Canadians in the Soviet Union." Globe and Mail (22 September 1983), 1. MacEachen's decision stands in sharp contrast to the government's extensive use of publicity in connection with earlier espionage and expulsion cases.

75. House of Commons Debates, Official Report (Hansard), 32nd Parliament, 1st Session, (4 October 1983), 27719-20. For other recent views on this issue see Stephen Woolcook, Western Policies on East-West Trade (London: Routledge and Kegan Paul, 1982); Technology and East-West Trade: An Update (Washington: US Congress Office of Technology Assessment, 1983); and Ellen L. Frost and Angela E. Stent, "NATO's Troubles with East-West Trade", International Security 8 (No. 1 1983): 179-200.

76. Speech at Dalhousie University Law School (28 October 1983). Soviet writers claim that the elements of the Prime Minister's peace initiative are similar to the views advanced by Moscow, and that, as an Izvestia political analyst put it, while Moscow is "ready to cooperate with Canada in the revival of détente" it is up to Mr. Trudeau to persuade "his southern neighbor to adopt a more realistic approach. . . . If the NATO circles are unresponsive to the Trudeau Plan, I hope nobody will blame the 'hand of Moscow'." Alexander Bovin, "Trudeau Plan--A View from Moscow", From the Soviet Press 133 (1 December 1983). Canada's decision in November 1983 to sell Nicaragua $3 million worth of wheat may undermine Mr. Trudeau's appeal as a positive mediator in the eyes of more conservative members of the Reagan administration. This may be offset, however, by the Canadian decision to go ahead with cruise missile testing. Stephen Clarkson has argued that the planned cruise missile tests illustrate how Canada's attempt to use a multilateral organization to offset its satellite relationship to the United States--in this case NATO--actually forces Ottawa back to bilateral dependence. Stephen Clarkson, Canada and the Reagan Challenge (Toronto: J. Lorimer in association with the Canadian Institute for Economic Policy, 1982), 281. The same argument is made by Soviet specialists on Canada, (interviews in Moscow, May 1983) who express both mild condemnation and a condescending tolerance for Canada's position. For a general overview of Soviet-Canadian relations through the first part of 1983, see B.I. Alekhin and I.B. Runov, "USSR-Canada: Developing the Cooperation", SShA (No. 9 1983): 55-61.

Table I: Soviet-Canadian Trade, 1956-1979 (in millions of rubles, 1961 prices)

	Soviet Exports to Canada	Soviet Imports from Canada		Total Trade Turnover	
Year	Total Exports	Total Imports	Total Imports Without Grain	Total Trade	Without Grain
1956-1958	2.6	17.6	1.6	20.2	4.2
1959-1961	4.2	21.2	8.5	25.4	12.7
1962-1964	3.4	150.5	3.8	153.9	7.2
1965-1967	15.2	222.1	7.0	237.3	22.2
1968-1970	11.9	87.0	6.8	98.9	18.7
1971-1973	17.3	220.5	9.8	237.8	27.1
1974-1976	34.2	340.2	40.8	374.4	75.0
1974	28.9	82.1	6.5	111.0	35.4
1975	31.9	439.3	57.4	471.2	89.3
1976	41.9	499.3	58.4	541.2	100.3
1977	49.2	368.8	46.5	418.0	95.7
1978	29.0	359.0	60.5	388.0	89.5
1979	33.0	453.0	95.3	486.0	128.3

Source: *Vneshniaia torgovlia SSSR. Staticheskii obzor.*

Table 2: The Composition of Canadian-Soviet Trade, 1980-1982 (thousands of Cdn. $)

	Canadian Exports to the USSR			Canadian Imports from the USSR		
	1980	1981	1982	1980	1981	1982
Live Animals	38	435	842	-	-	-
Food Products	1,288,985	1,757,269	1,924,579	547	665	801
Crude Materials	50,728	44,355	47,110	603	1,020	827
Fabricated Materials	124,864	46,898	65,208	14,730	10,582	4,241
End Products	70,246	16,621	29,049	43,225	64,653	36,719
Special Transactions	-	3	6	378	749	260
Total	1,534,861	1,865,581	2,066,794	59,483	77,669	42,848
Year-to-Year Percentage Change	+101.2	+21.5	+10.8	-7.5	+30.6	-44.8

Source: Derived from Statistics Canada, Export by Countries and Imports by Countries.

Table 3: Total Soviet Grain Imports by Country of Origin for Three-month Periods, 1980-1981* (thousands of tons)

Grain-Exporting Countries	July-Sept. 1980		October-Dec. 1980		January-March 1981		April-June 1981		Total July 1980-July 1981	
	thous. tons	%	thous. tons	%	thous. tons	%	thous. tons	%	thous. tons	%
United States	0	0	3,867	43.9	2,705	33.3	428	4.2	7,000	21.2
Canada	2,315	39.2	2,023	23.0	354	4.4	2,200	21.6	6,892	20.9
Australia	648	11.0	799	9.1	978	12.1	437	4.3	2,862	8.4
European Community	250	4.2	115	1.3	375	4.6	396*	3.9	1,136*	3.4
Argentina	1,821	30.9	886	10.1	2,654	32.8	5,847	57.3	11,208	34.0
Other Countries	866	14.7	1,110	12.6	1,034	12.8	892	8.7	3,902	11.8
Total*	5,900	100.0	8,800	100.0	8,100	100.0	10,200	100.0	33,000	100.0

Source: Derived from data in US Department of Agriculture, Foreign Agriculture Circular: Grains (11, Dec. 1981), p. 5.

Note

* Preliminary data

3: COMMERCIAL POLICY AND THE INDUSTRIAL STRUCTURE: AN HISTORICAL PERSPECTIVE

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COMMERCIAL POLICY AND THE INDUSTRIAL STRUCTURE: AN HISTORICAL PERSPECTIVE

Introduction

During the past decade, Canadians have been forced to reconsider the basis of their economy's prosperity as well as the prospects for the future. One frequently hears that the Canadian economy is "in trouble". Among the solutions advocated is the full implementation of a "new industrial strategy" that would necessarily involve protectionist international trade policies. While few would argue that the Canadian economy is healthy, it is still necessary, when thinking of its ills, to separate those that are a manifestation of the depression phase of the business cycle from those that are long-term and structural.

This study seeks to examine the structural nature of the Canadian economy in the 1970s and early 1980s, with particular reference to commercial policy, its attempts to shape the pattern of trade, and the likely economic efficiency and welfare costs. Particular emphasis is placed on Canada's trade in manufactured goods. In the first section, the trade history of the past decade is summarized. What is new here are the calculations that show Canada's manufactured imports by industrial end-use rather than by trade classification. In the next section of the paper, these data are used to examine hypotheses about the interrelationships between imports and the performance of manufacturing industries. This is accomplished by modelling the production processes of Canadian industry at the two digit level, using a set of factor demand equations that consider separately the role of various inputs, including imported manufactured intermediate goods. In the subsequent section, the history of recent trade policy and attitudes about it are presented. The paper ends with a few summary observations.

To anticipate the general conclusions of this review and technical analysis, we draw attention to a worrisome aspect of contemporary trade policy: the renewal of protectionism. Since the General Agreement on Tariffs and Trade (GATT), there has been a world-wide tendency towards reduced tariffs and no obvious threat to a reversal of trend. While existing tariffs may impose an economic burden, it is unlikely that these will change in proportional importance. Rather, the threat to freer international trade now comes in the form of non-tariff barriers enacted by governments to serve some policy end previously played by the tariff. This growing threat to trade liberalization from all quarters has been noted by many,[1] but most recently by the Royal Commission on Economic Union and Development Prospects.[2] Many of these non-tariff barriers are well-known: the manipulation of quotas, valuation procedures, government procurement among others. Others are less readily appreciated but nonetheless real, such as the current Canadian claim that European Economic Community (EEC) building codes deliberately discriminate against the use of Canadian lumber. New forms of discrimination in trade are often associated with "new" arguments for trade limitation. Arguments made by the Science Council of Canada (SCC)[3] emphasize such dubious concepts as "national technological sovereignty" and are among many with sound mercantilist antecedents. We refer to this type of argument and the new threats to trade limitation as "The New Mercantilism".

Canada's Trade in the 1970s

Descriptions of Canada's external trade[4] and projections for its development often take on the quality of hyperbole. Perhaps this is not surprising, since policymakers and public commentators tend to stress new trade initiatives, new markets, and other incremental adjustments. While the economists may find this concern for the margin to be touching, undue emphasis on such projections may obscure the general and so far more enduring features of Canada's external trade. It is pertinent then, at the beginning of this series, that we review the economic history of Canadian trade in the 1970s, with particular emphasis on its composition, origins, and markets. Here we will stress the continuing importance of the United States as Canada's trading partner, a relationship that changed very little under the pressure of the oil crises, the slow-down in domestic productivity growth, and the depression of the early 1980s.

One of the difficulties of describing Canadian external trade in the 1970s is that it takes on the pattern of one of the major trade changes of a few years earlier: the Canada-United States Automotive Agreement, or the Auto Pact, which resulted in free trade in automobiles and their parts between the two countries. "In 1961, the assembly operation of automobiles and trucks exported 2.3 per cent of total Canadian production, while the parts sector exported about 6 per cent; by 1970, the respective figures were 77.8 and 69.8 per cent."[5] Naturally, imports in the same categories rose as specialization took place on both sides of the border and economies of scale were gathered. The initial result in net trade terms was a slight reduction in Canada's negative balance in the automobile trade, which has become a positive balance in recent years. As most readers will be aware, it is a matter of continuing controversy that the full welfare benefits of the Auto Pact are not passed on to Canadians because free trade does not extend down to the level of the individual consumer. Potential threats to the stability of the Canadian/US auto trade--in such forms as Canadian content requirements on non-North American automobile producers selling in Canada--are also a matter of continuing concern.[6]

Table 1 shows the relatively stable and important status that both exports and imports of transportation equipment have in modern economic history. Imports of motor vehicles and their parts rose from an index value of 100.0 in 1971 to almost 400.0 in the first quarter of 1979. One quarter earlier, the peak of just under 350.0 in exports of motor vehicles and their parts had been reached. The same peaking pattern is shown by the "fixed weighted volume index", but with both indices for imports and exports reaching approximately the same level of 200. The late seventies, however, records the decline in the value of the automobile trade--one of the harbingers of depression. Not until the first quarter of 1983 did exports and imports penetrate the 400.0 level of the value indices on a continuing basis: it was the long-awaited recovery.

Some commentators felt that the greater variation of exports and their slower growth (by value) compared with imports of motor vehicles and their parts was a sign that trade was weakening.[7] The Canadian, if not the entire North American, automobile industry failed to match the productivity gains being registered by countries like Japan, whose automobiles increasingly penetrated the Canadian market in the 1970s. This concern led in turn to some bizarre public policy in both the United States and Canada, which attempted in part to stem the inflow of Japanese cars. On the British Columbia docks, Japanese cars were systematically subjected to extraordinary scrutiny by customs officials in order to bring chaos to the orderly marketing of Japanese cars.[8]

In terms of total external trade, Canada's merchandise exports increased from $17.8 billion in 1971 to $83.8 billion ten years later. Growth of exports in physical terms was rapid only during the very early 1970s and between 1976 and 1978. Indeed, during the period associated with the first oil crisis and its aftermath, 1973 to 1975, the recorded volume of Canadian exports declined by index measurement from 121.1 to 108.1 (where 1971 = 100.0). Table 2 illustrates that the recovery of export volumes was relatively rapid at mid-decade. Between 1978 and 1983, however, there has been little real growth in exports.

Merchandise imports in 1971 were approximately $15.6 billion in current value. Just as in the case of exports, the value of imports increased during the decade, with the greatest proportion of the increase being accounted for by the influence of price. By 1981 the value of imports increased to $79.5 billion, but the volume index over the decade increased from 100.0 to 165.7. Notably, and quite different from export performance, the underlying cycle in imports in the early 1980s was of much more severe amplitude. A long cycle reached a trough in late 1983 after 18 months of declining trends.

One of the most profound shocks to the composition of Canada's trade during the 1970s was the sharp increase in the value of crude petroleum exports and imports. The effects of the sudden and largely unanticipated price rises orchestrated by the Oil Petroleum Exporting Countries (OPEC) cartel, however, were different on exports than they were on imports. As might be expected, the value of oil exports rose dramatically in 1973 and 1974. The value of these exports was then modified to the pre-crisis level with another round of price increases in 1978 and 1979, pushing their value up again to the level achieved in 1974. Since the late 1970s, the value levels for crude petroleum exports have traced out the trough phase of a business cycle. The value of oil imports shot up in 1973 and 1974, but unlike imports of oil, remained at this new higher level until the price shock at the end of the decade once again raised their value. In the early 1980s, their value declined both as Canada reduced crude oil imports and as their price fell.

Although the imports of crude oil in value terms remained high in the immediate post-1974 years, it is important to note that in a growing trade bundle the proportional importance of oil imports declined secularly in the late 1970s. As can be seen in Table 4, the Middle East suddenly becomes prominent as a source of Canadian imports at mid-decade but declines in proportional importance on average for the rest of the decade and even into the 1980s. While we examine the relationship between energy prices and the demand for non-energy imports later in this study, it is sufficient for descriptive purposes to note that the unusual price shocks distorted the proportional value composition of trade by commodity and by origin and source in the late 1970s. These abnormalities are either gone by the early 1980s or are no longer oddities, as the adjustment to new higher prices is in some measure complete.

Tables 3 and 4 record the history of Canada's exports and imports by destination of shipments and origin, respectively. Despite the oil crisis, despite policy objectives to broaden the export base (the so-called third option), despite the effects of the world-wide price inflation, and despite the re-emergence of a more pronounced business cycle activity, the overall pattern was one of stability. In both imports and exports, Canada's major trading partner is the United States. Nor is there evidence of any lessening of the trade bonds between the two countries, in spite of yearly variations. Merchandise imports from the United States in the early 1970s as a percentage of Canada's total imports were almost the same as in the late 1970s and the early years of this decade. So too, merchandise exports to the United States as a proportion of all Canadian exports were the same at the end of the decade as they had been at the beginning. Tables 3 and 4 demonstrate the well-known fact: that the United States is slightly more important to Canada as a source of imports than as a destination for exports. Neither is the overall stability of Canada's trade relationship with the United States surprising, given the long historical context and the context of the Auto Pact mentioned above.

One of the major trade strategies of the 1970s was the attempt to increase trade among the Pacific Rim nations. Such a policy was, and continues to be, vigorously pursued by both the federal and provincial governments. The rapid economic growth experienced by Asian Pacific countries in general, offers much opportunity for trade-linked investments as well as for the growth of markets for Canada's exports.[9] Also important was the fact that new, but relatively ill-defined markets were developing for Canadian exports: China had re-entered the world trading community and was now seeking out products other than agricultural goods; the Japanese market was under attack by other nations, who deprecated its non-tariff barrier restrictions on imports; and the trade strategies of countries such as South Korea and Japan were being restructured to take account of the new and higher post-1973 energy prices.

Canadian efforts in the 1970s to increase trade in this region yielded significant results, especially when one considers how small Canada's Pacific Rim market originally was. Over the decade, as evident in Tables 3 and 4, Canadian exports to this area increased by about 2 per cent, and the Pacific Rim market now accounted for 11.0 per cent of the overall export bundle; almost all of this increase came from shipments to the Asian Pacific Rim countries, particularly Japan. However, it should be noted that the increases in exports to Japan in the late 1970s (from $200 million in value at the beginning of 1977 to $410 million in value in early 1980) have not been sustained in the early years of this decade.

As Canadian trade turned slowly towards the Pacific Rim nations it slowly turned away from Europe. This trade diversion occurred once the United Kingdom entered the EEC. Figure 1 illustrates the relative importance of the EEC and Pacific Rim markets in Canadian imports and exports.

By commodity, the pattern of merchandise trade changed little during the 1970s. Table 5 records the broad categories of this trade for the year 1979. Export shipments by industry are shown in Table 6. As was the case earlier, any description of trade in proportional terms for the 1970s must give due consideration to the sudden increase in the price of oil and oil-based products. This effect notwithstanding, the pattern of shipments indicates that the export structure was relatively stable during the seventies, which was quite unlike the previous decade. The rank of the five major export industries was as follows:

1968	1974	1980
Transport Equip.	Mining (incl. Oil)	Mining (incl. Oil)
Mining (incl. Oil)	Transport Equip.	Transport Equip.
Paper & Allied Prod.	Paper & Allied Prod.	Paper & Allied Prod.
Primary Metal Prod.	Agriculture	Primary Metal Prod.
Agriculture	Primary Metal Prod.	Agriculture

Again it should be noted that the transportation equipment industry regained its primacy of rank in the early 1980s.

One of the difficulties in estimating the demand for imports into Canada is our current inability to distinguish between goods for final consumption and those imported for further processing as intermediate goods. Neither the Standard Industrial Trade Classification (SIC) nor the end-use reporting of Canadian trade are particularly helpful in this regard. In order to distinguish between goods for final consumption and those for further processing at the industry level several unique manipulations of extant trade data were attempted. All imports were reclassified and further categorized as finished goods or intermediate ones. Intermediate goods are those requiring further manufacture before being sold to consumers (or producers). For a full description of the procedure used, see Appendix A. It also should be noted that for several sectors the data manipulation could not be done satisfactorily.[10]

First, in terms of all merchandise imports classified by SIC designation, their composition over the period 1969-79 is exceptionally stable, again, notwithstanding the effect of the oil crises. (See Table 7) Another thing to note is that the proportion of imported intermediate goods to total industry output in manufacturing varies considerably from industry to industry; these proportions have nonetheless been relatively stable in recent years. Listed below are the averages of the value of imported intermediate goods to the value of industry output for Canadian manufacturing from 1968 to 1979:

SIC	501	Food & Beverages	0.314
SIC	503	Rubber & Plastics	0.199
SIC	504	Leather Products	0.374
SIC	505	Textiles	0.859
SIC	506	Knitting	0.819
SIC	508	Wood Products	0.215
SIC	509	Furniture & Fixtures	0.670
SIC	510	Paper & Allied Industries	0.016
SIC	512	Primary Metals	0.925
SIC	513	Metal Fabrication	0.502
SIC	516	Electrical Products	0.815
SIC	517	Non-metallic Minerals	0.329
SIC	519	Chemicals & Products	0.678

To anticipate a later discussion we will argue that policies that attempt to discourage the use of imported intermediate goods in Canadian manufacturing will have several negative effects, among them being the loss of scale efficiencies.

In summary, Canada's external trade was subject to more severe shocks in the 1970s than at any time since World War Two. Particularly disruptive were the oil price crises of both the early and late years of the decade. The volume of trade was severely affected as a result, with almost no trade growth in real terms in the late seventies. Yet despite these major problems, the composition of external trade changed very little in terms of both trading partners and commodity groups.

Manufacturing and the Demand for Imported Intermediate Goods: Short-term Adjustment and the Industrial Structure

Commercial policy influences the structure of manufacturing in several ways, especially if that policy is a long-standing one. Restrictions on the entry of goods for consumption encourage the growth of import-replacement industries, often at inefficient levels of output. Resourse allocation distortions brought about by such protection may raise the cost of inputs in other industries, which in their absence might have had internationally competitive per-unit costs. Commercial policy that serves to increase the cost of imported intermediate goods also raises per-unit costs for the Canadian manufacturing industry. Any increase in costs comes about in a complex manner, determined by the degree of factor substitutability. Unfortunately, there is little empirical evidence for Canada (or elsewhere for that matter) that demonstrates the interrelatedness of factor demand in manufacturing when one of those factors is imported.[11]

Canadian policy has for a long time been one of effective protection for domestic manufacturing. The trade policy issues are thus twofold. First, what would be the influence of increased discrimination against imported intermediate goods on the demand for domestic manufacturing and how would this affect the demand for other inputs in manufacturing? Second, if increased discrimination against imports for final demand leads to domestic industrial expansion, what are the consequences for the industrial structure as a whole?

The aggregate demand for imports is usually written as a function of the relative price of imported as opposed to domestically-produced goods. We would also expect that the demand for imported intermediate goods as inputs into manufacturing would depend upon the price structure as it relates to the production technology: substitution possibilities, technical change, and economies of scale would affect their desirability. This analysis focuses on the role played by these imported intermediate goods at the disaggregate level of Canadian manufacturing. The level of disaggregation is given in Table 8 and the data are described in Appendices A and B.

For each two-digit sector of manufacturing we propose an economic model whose specification takes into account both ordinary substitution effects and biased technical change as well as the source-of-scale effects. All tests are based on a system of real factor demand equations derived from a cost function that is dual to the Generalized Leontieff production function.

The actual functional form adopted here is the Parks-Woodland adaptation of the Diewert formulation of a Generalized Leontieff cost function. The factors in question are: labour, capital, energy inputs, and imported intermediate goods. Output and time are included as right hand variables representing the effects of scale and technological change, respectively. This cost function is

$$(2.1) \quad C(Y,P,T) = Y \sum_i \sum_j \beta_{ij}(P_i \cdot P_j)^{1/2} + Y^2 \sum_i \beta_{Yi} P_i + Y\beta_{ti} T P_i$$

where i, j = 1, 2, 3, 4
Pi = price of factor i
Y = gross output, and
T = time

the marginal cost function corresponding to (2.1) is

$$(2.2) \quad \frac{\delta C(Y,P,T)}{\delta Y} = \sum_i \sum_j \beta_{ij}(P_i \cdot P_j)^{1/2} + 2Y \sum_i \beta_{Yi} P_i + \sum \beta_{ti} T P_i$$

and allows for constant $(\beta_{Yi} = 0)$, increasing $(\beta_{Yi} < 0)$ or decreasing $(\beta_{Yi} > 0)$ returns to scale and for factor saving $(\beta_{ti} < 0)$, factor using $(\beta_{ti} > 0)$ or neutral $(\beta_{ti} = 0)$ technological change.

There are certain regularity conditions that must be fufilled if any cost function is considered to be well-behaved and to adhere to the tenets of microeconomic production theory. In general, if a producer is facing n fixed factor prices p=(P1, P2. . .Pn)T corresponding to n factors X=(X1, X2. . .Xn)T, and has a minimum total cost function which may be defined as:

(2.3) $C(Y;P) = \min [P'X] \qquad P \geqslant 0_n$

then the following conditions must be satisifed:

(i) C(y;p) is a positive, real-value function defined and finite for all finite y, $y, y \geqslant 0, p \geqslant 0_n$

(ii) $C(y^1;p) > C(y^2;p), y^1 > y^2$; has a left hand limit of plus infinity as y tend to plus infinity for every $p \geqslant 0$ and C(y;p) is left continuous in y

(iii) C(y;p) is non-decreasing in p

(iv) C(y;kp)= $kC(y;p), k > 0, \text{ for } y > 0$

(v) C(y;p) is a concave function in p for every $y > 0$.

In terms of the cost function (2.1), these conditions will be fufilled if and only if the following occurs:

(i) $\beta_{ij} \geq 0$

(ii) $\sum_i \beta_i, \sum_i \beta_{yi}, \sum_i \beta_{ti} \geq 0$

(iii) is positive real valued if (ii) hold and at least one $\beta_{ij} > 0$

(iv) $\sum_i \beta_{yi} \geq 0$

(v) C(Y,P,Y) is linearly homogeneous in p.

Note that the restriction (i) rules out complementarity of factors. We would expect complementarity to be observed between certain factor pairs, such as capital and energy in many industries, hence it will be necessary to verify that

(i) $\sum_j \beta_{ij}(P_j/P_i)^{1/2} \geqslant 0$ for all i, and that

(ii) the matrix of second order partial derivatives of the estimated cost function is negative semi-definite when evaluated at the sample factor prices.

With Shephard's lemma, if we differentiate (2.1) with respect to the i factor prices we will arrive at a system of four input demand equations:

(2.4) $\frac{\delta C(Y.P.T)}{\delta P_i} = Y \sum_j \beta_{ij}(P_j/P_i)^{1/2} + \beta_{iY}Y^2 + \beta_{iT}TY$

for i = 1,2,3,4 corresponding to the factors indentified for (2.1) above, dividing through by Y, we obtain the input demand equations corresponding to the minimum total unit cost function or the N input-output coefficient functions

(2.5) $A_i(Y.P.T) = \sum_j \beta_{ij}(P_j/P_i)^{1/2} + \beta_{iY}Y + \beta_{iT}T$

Estimation of (2.5) provides us with a model with which we can test that:

(i) there are no factor substitution possibilities,

(ii) the technology underlying the production process displays constant returns-to-scale, and

(iii) factor-saving technological change has occurred over the same period.

The system of equations to be estimated is:

(2.6) $A_i(Y.P.T) = \sum \hat{\beta}_{ij}(P_j/P_i)^{1/2} + \hat{\beta}_{iY}Y + \hat{\beta}_{iT}T + \mu_i$

i=labour, capital, energy, imports

where ui is the disturbance term for the i-th factor demand equation and the restrictions $\beta_{ij} = \beta_{ji}$ are imposed.[12] The parameters $\hat{\beta}_{ij}$ are not capable of bearing any straightforward interpretation but are the basis of calculating Allen-Uzawa own- and cross-elasticities of substitution as well as the own- and cross-price elasticities of factor demand. As such, values of zero imply no factor substitution. On the other hand, both $\hat{\beta}_{iY}$ and $\hat{\beta}_{iT}$ can be directly examined. A significant and negative value of the former indicates the presence of economies of scale with respect to factor i's use; as real output grew the per-unit factor demand (or alternatively stated, the input-output coefficient) fell. Positive values of $\hat{\beta}_{iY}$ measure diseconomies of scale with respect to the factor. The $\hat{\beta}_{iT}$ parameters indicate the presence or absence of Hicks biased technical change with respect to the factor price. Factor i-saving and factor i-using changes are indicated by significantly negative and positive values of the coefficient respectively. Values insignificantly different from zero detect

Hicks neutral technical change.

The above approach permits the statistical testing of certain theoretical variations of the neo-classical production model. First, the appropriateness of the alternative specifications is tested by means of log likelihood tests. These tests compare the logarithmic likelihood value of the model under specified restrictions (embodied in the null hypothesis) with that obtained when the restrictions are relaxed (the maintained hypothesis). The log-likelihood statistic is the negative of twice the difference between the log-likelihood value obtained under the restricted model less the log-likelihood value of the maintained (unrestricted) model. This statistic is distributed Chi-squared with one degree of freedom for each restriction imposed under the null hypothesis. Unless the calculated value exceeds the critical value, we cannot reject the null hypothesis at the chosen level of confidence.

The model specifications under consideration are listed below:[13]

Specification I - full model with no autocorrelation
Specification II - full model corrected for autocorrelation
Specification III - zero factor substitutability imposed (ZFS)
Specification IV - constant returns to scale imposed (CRTS)
Specification V - zero technological change imposed (ZTC)

In all of the likelihood ratio tests reported here, Specification II is the maintained model (alternative hypothesis).[14] Since our primary interest here is to examine the manner in which imported intermediate goods affect production decisions in Canadian manufacturing industries, it is necessary to examine all the model specifications in some detail.

Table 9 gives the log-likelihood values of the estimations for each of the model specifications. For several of the estimations, the sensitivity of the model required increasing the power convergence criterion, so the number of iterations required for convergence are also given. One sees that the convergence for several of the sectors was not achieved without some difficulty. This is especially true for SICs 504, 506, and 519 and this is also seen to be the case, albeit to a lesser extent, for 505 and 513. This relative instability requires us to use some care when considering these sectors. Indeed, the results obtained for SIC 519 are so far removed from anything resembling conventional economic theory that we have chosen to exclude this industry (Chemicals and Allied Products) from consideration throughout most of this study, although summary results are presented. Such exclusions reduce to fifteen the number of industries under study.

The results of the actual likelihood ratio tests are found in Table 10. Both Specifications I and IV are rejected for every industry at the per cent level. Other tests do not yield rejection of the null hypothesis for all industries.

Given the nature of the data it is not suprising that Specification I should be rejected in regressions involving times series; successive observations are likely to be serially correlated. The values of the autocorrelation coefficients are reported in Table 11. In all but two cases (SIC 501--labour and SIC 515--capital) the values of rho are positive. In eleven of the other fourteen industries, the highest degree of autocorrelation is found in the capital demand equation, whereas the labour time series appears to suffer least from serial correlation. Indeed, in three industries (501, 512, and 519) the value of rho is not significantly different from zero at the 5 per cent level.

The global rejection of constant-returns-to-scale (Specification III) has far more important ramifications. First, conventional economic analysis has usually held that the domestic Canadian market is too limited in size to take advantage of many scale economies, although some could be acheived with the winning of an export market. This, indeed, can be seen to be the case in Table 12, where the reported scale coefficients for all inputs in every sector indicate that increases in output lead to lesser input requirements for every unit of output, that is, a fall in the input-output coefficient. When overall scale effects (the summation of individual factor scale effects) are considered, one might expect that in highly protected industries the potential scale economies are most pronounced. This would be the case if the protected industries were operating at that point on their average cost curve where a given increase in output would yield sizable reductions in per-unit costs instead of at those higher levels of output where the same increase in output would result in much less significant reductions in per-unit costs. However, no clear pattern emerges when comparing the overall scale effects for industries that enjoy differing degrees of protection.

When considered on a factor-by-factor basis, capital and imported intermediate goods tend to display greater economies. Economies of scale in energy usage, on the other hand, appear to be very limited. The implications here are that, for Canadian manufacturing as a whole, expansion of market size and hence scale of production will encourage greater utilization of capital and imported intermediate goods.

Second, even if one allows the premise that the Canadian market is of a size sufficient for the exploitation of all scale economies, it does not appear that the erection and maintenance of tariff and non-tariff barriers has allowed the domestic manufacturers to exploit these economies. Not surprisingly, this suggests that too many firms supplying the domestic market are operating at a sub-optimal level of output. If the Canadian market could support firms that are able to exploit all potential plant economies then the appropriate way to lower unit production costs and increase factor utilization efficiency would be to encourage mergers, takeovers, or any other action that would increase the size of a firm. If only a few optimally sized firms are economically viable then the problems of monopolistic/oligopolistic pricing and behaviour are likely to appear.

Finally, our results confirm that unexploited economies of scale are still common in the Canadian manufacturing sector, a full decade and a half after Eastman and Stykolt[15] first examined this issue. (We return to this observation later.) Neither an expanding domestic market nor recent changes in technology (which are often alleged to have reduced the minimum efficient plant size) appear to have allowed any of the industries under analysis to achieve maximum production efficiency.

This might lead one to expect that little or no factor-saving technological change had occurred in the Canadian manufacturing sector between 1968 and 1979. This, however, is not the case. Tests for zero technical change show that only three of the sixteen industries under consideration were found to be unaffected by changing technology. (See Table 13)

It is often alleged that certain industries have suffered technological stagnation as a result of Canadian tariffs. If this was true, we would not expect to find that technological change had been so prevalent in the 1968-79 period. In sectors that have traditionally enjoyed a high degree of government-sanctioned protection from foreign competition (industries 503--rubber and allied products, 505--textiles, and 516--electrical machinery), the null hypothesis cannot be rejected at the 95 per cent level of confidence. For these industries, it is possible to speculate that such sheltering from foreign competition has allowed the Canadian manufacturers to continue using outdated and inefficient technology in the face of imports produced with greater efficiency and, hence, lower costs. We might expect similar results for industries such as clothing and knitted goods, but in fact we find that zero technological change is strongly rejected. Here we must be careful of the temptation to infer that any evidence of changing production technology indicates that the industries are using either the most advanced or lowest-cost technology available. Our results simply indicate that some technological change has occurred over the 1968-79 period, not that Canadian manufacturers are at the forefront of new developments. Indeed, there is nothing in our analysis that served to refute the 'technological backwardness' hypothesis currently in vogue.

On balance, technical change was of the labour-saving variety. From Tables 13 and 14, we can see the effects of technical change on the demand for labour, with twice as many industries indicating a labour-saving as opposed to a labour-using technological bias at the 5 per cent level. For the other factor inputs, the trend is much more consistent across industries. Technical change has been captial- and energy-using and import-saving in two out of every three industries studied. It is interesting to note that the results obtained from Specification II show that those industries that experienced labour-using technological change also experienced capital-using technological change; only imported intermediate goods appear to have been displaced as a result. Labour-saving technical change has occurred in the six industries for which zero technological change was rejected. In three of these six industries, capital as well as import demands have experienced factor-saving change.

By far the most surprising conclusion of this study is that for most industries, zero factor substitutability cannot be rejected. Our analysis tested for the substitutability among the factors of production: labour, capital, energy, and imported materials. As evident from Table 10, in nine of the sixteen industries in the manufacturing sector we cannot reject the hypothesis of no joint factor substitutability. Factor substitution possibilities appear feasible in food and beverages, leather goods, knitwear products, primary metal production, petroleum and its products, and chemicals and their products. Although the estimated substitution elasticities vary considerably from industry to industry, they are typically small, which is to say they were smaller than those found when using models with constant return to scale. In particular, complementarity between imported intermediate goods and other factors cannot always be ruled out, but there is no simple pattern across industries. In brief, we find that Canadian manufacturing industries display greater rigidity in the relative employment of factors of production than we expected and greater rigidity than is often found.

In Table 15 we present the own-price coefficients for our model Specifications II and III. In most cases the restriction of off-diagonal coefficients to zero leads to an increase in the magnitude of the own-price coefficients. This suggests that inclusion of cross-price effects when they are actually insignificant will lead to an under-estimation of the own-price effects. This appears to be the case for SIC 501, 516, and 517 and, generally, to be more pronounced for the labour-price coefficients.

As noted earlier, the parameters β_{ij} do not lend themselves to easy interpretation, but as can be seen from equation (2.5) any increase in the price of the i-th factor relative to the price of the j-th factor will lead to a change in the demand for the i-th factor. This change will take the same sign as the coefficient β. To see this one must differentiate equation (2.5) with respect to any P and divide the result by X/P to yield the cross-price demand elasticity. Viewed this way, a positive β usually indicates that the i-th and j-th factors are substitutes, whereas a negative value would be associated with complementary factors of production.

Table 16 examines the cross-price coefficients on the basis of their sign and individual level of significance. Although all the cross-price coefficients for all industries tend to be positive (substitutes), in those industries for which zero factor suitability (ZFS) could not be rejected this tendency is more pronounced. The exception to this is the capital/energy cross-price term. This is also the cross-price coefficient that is most frequently statistically significant, which indicates that with the exception of capital and energy, input pairs tend to be substitutes in the production process. For both industry groupings found in Table 16, energy/labour and energy imports most frequently display substitution possibilities. For those industries characterized by joint factor substitutability (JFS) labour and capital appear as substitutes twice as often as they are complements in the production of manufactured goods. In industries where our results indicate no joint factor substitution possibilities, labour and capital cross-price coefficients are negative almost as often as they are found to be positive, indicating that these factors are often complements in the production process.

Our results indicate that the relative increase in the price of energy, which occurred in 1973 and again in 1979, encouraged substitution towards labour and non-energy imported intermediate goods and likewise discouraged more capital intensive processes. This effect comes as no surprise; capital/energy complementarity is well established.[16] What is not intuitively apparent, however, is that increases in the price of energy encourage domestic manufacturers to use more imported intermediate goods. This might be an indication that the production of semi-finished manufactures tends to be more energy intensive. The effect of import price increases is not as straight-forward. In four out of a possible six cases where there is JFS, both the L/M and K/M coefficients indicate that the input pairs are substitutes. Presumably imported intermediate goods displace domestic production of the same goods. But from our results, it is not clear whether it is capital or labour that suffers the greatest displacement when the use of imported intermediate goods increase. In the lower portion of Table 16, we present the results for the six industries for which zero factor substitutability was rejected. Once again, while all other results are mixed, imports of intermediate goods and energy are clearly substitutes.

Long-term Adjustment and Trade Policy

In the previous section of this study we examined the likely short-term adjustment that would take place in the industrial structure as a result of changes in the import of intermediate goods. But trade policy has both a short- and long-term dimension; it is to the long-run that we now turn. While it has been argued that Canada has never had a coherent "industrial strategy",[17] there is a long and reasonably consistent history of protectionism. Like many other economists, we conclude that many of the alleged long-term or structural "problems" of the Canadian economy today are in fact a direct or indirect result of that long history of trade policies based on persistent but false premises. We fear that the Government of Canada is in the process of seriously aggravating the situation by intensifying these damaging policies as a short-sighted response to short-term ailments, or as an attempt to reach ill-conceived economic goals. It is time to review again some "plain home truths"; this we propose to do in an historical framework.

Our conclusions can be briefly summarized. Recent Canadian policies with respect to international trade

- are broadly consistent with the principal themes of government policy since the establishment of the modern Canadian economy,
- have been, and will continue to be, largely ineffective in altering patterns of trade or the industrial structure in the

directions intended by policy, and

- have nonetheless been and will continue to be effective in lowering the level of individual economic welfare by reducing the potential gains from international trade.

Beyond these historical points, we conclude that

- the arguments against free trade as the appropriate policy for Canada have been based on mercantilist notions, and reflect a deeply ingrained national delusion that we call the "Canadian Disease". The economic arguments and evidence in favour of free trade have not been seriously rebutted and for now must represent the "best practice technology" in the production of national economic policy. All other industrial strategies are bound to perpetuate and accentuate economic distortions, and continue to aggravate the income penalty of being a Canadian.

If these conclusions have a familiar ring it is because they are the standard and familiar results of conventional economic analysis. They require frequent repetition because they are systematically ignored.

An Historical Constant?

Per Capita Income in Canada and the United States

A useful starting point for a discussion of Canada's international trade policies is John Young's 1955 "impression" that "at the terminal points of the major periods of Canada's economic development--1870, 1900 and today mid-1950s --the ratio between income per capita in the two countries may not have changed very greatly".[18]

The international comparison of real income levels is an uncertain art. Theoretically, pure comparisons are probably impossible. Conceptually, defensible ones are difficult, time consuming, and very demanding of data: For these reasons comparisons are few in number. The problems are especially difficult when we attempt to make such comparisons far into the past. For the nineteenth century and even the early twentieth century, statistics of national income are, to say the least, imperfect, and the basis for international comparisons of purchasing power, using alternative weighting systems, are almost non-existent. However, John Dales put some statistical flesh on Young's conjecture for the period 1870-1960.[19] Using the raw data, he showed Canadian GNP per capita fluctuating in the range 70-80 per cent of US GNP per capita, an observation which became a central element in his analysis of the interaction between Canadian commercial policy and economic development.[20] Young's impression also receives support in Walters' more careful income comparisons for the post-war years and from casual averaging of the raw data (converted at the market exchange rate) for later years, although the data for the second half of the 1970s may raise some doubts.

Do we have here an empirical "constant"? Does Canadian per capita income tend spontaneously to be 75 per cent of US per capita income?

Not surprisingly, on close examination, the apparent constancy proves to be illusory, particularly in the short term, and especially in more recent years. Thus, Young's further prediction that "there have undoubtedly been short-term fluctuations in this ratio which will be revealed when and if we obtain better information",[21] is amply justified by the data. Nonetheless, over the longer span of history, in spite of occasional short-term aberrations, John Young's impression is correct. Real income per capita in Canada has tended to be persistently less than that in the United States--a real income penalty of about 25 per cent for living north of the US border. Why should this be a persistent feature of the Canadian condition?

The Productivity Gap

Short-term changes in the income ratio are frequently a result of changes in the international terms of trade. However, a persistent long-term income differential will have its roots in the differential productivity of factors of production owned by residents of Canada. Attempts to account for differential growth rates also identify effects from changes in the composition of output, but in a broad sense that is an aspect of productivity.[22] An explanation for the historical income gap, then, must be an explanation for differential productivity of factors of production owned by Canadians.

We know of no general theoretical reason why the productivity of Canadian factors of production should be persistently less than that of US factors of production, producing an income gap that has lasted for over a century. Of course, ad hoc explanations abound. A common one implies that there will be a sub-optimum population, given heavy national overhead costs because of the extensive transportation network and the provision of government services.[23] Some emphasis has also been placed on lower levels of education of Canadian workers,[24] and "harder working US employees",[25] as well as the relative utilization rates for productive factors. We are not going to attempt a review of all of this literature. Rather, in light of their relevance for current controversies, we focus on only two hypotheses:

- the direct and indirect implications of the commercial policies of Canada and the United States, an explanation much beloved by economists; and
- the technological backwardness of Canadian society, an explanation much beloved by sociologists and scientists.

Before we examine the economists' explanation, it is useful to review in brief the history of Canadian commercial policy. We do not do so in meticulous detail, but in the inimitable phrase of our theorist friends, only summarize the "stylized facts".

Historical Themes in Canadian Commercial Policies

The establishment of a Canadian international trade policy began in the early 1800s. Previous to that, the North American colonies were part of a preferential trading region (not quite a customs union), based on imperial mercantilist precepts, which Canadians observed, but over which they had little influence. The regulation of Canada's international trade and Canada's prosperity depended on the administration by Great Britain of complicated (and changeable) tariff structures, which included semi-automatic price switches regulating competition from non-imperial sources for our two major staples, wheat and timber. Although they were not of our design, mercantilist principles were deeply ingrained in the earliest Canadian experiences with trade policy. What were these principles?

Mercantilism

Historical mercantilism did not reflect a coherent disciplined body of thought. Rather, it was a collection of ad hoc propositions and policies, each of which appeared to be "common sense", but when put together contained frequent contradictions and illogical conclusions. The important first principle was that the national well-being is something very different from the sum of individuals' well-being. Historically, such a proposition is understandable in an age of absolutism, when war or the threat of war was the normal state of affairs and when a particularly aggressive notion of nationalism was rampant. The objective of mercantilist policies was to maximize the national well-being in this sense.

These mercantilist objectives were to be achieved through government activities: taxation, subsidization, regulation, and the granting of property rights, including monopoly rights. Markets were to be used and directed as instruments of policy, not as reflectors of individual choices, and hence guides to policy. Full employment was an important goal, but not in the Keynesian sense of minimizing involuntary unemployment, although it clearly encompassed that. Rather, the objective was to maximize voluntary or involuntary employment and particularly employment in jobs judged to be of value to the nation. In this there was a notable emphasis on "technology", that is to say on how technology could contribute to the mercantilist concept of the national well-being, particularly national defence. It was important to have superior technology and equally important to deprive your enemies of such technology.

The best known propositions of mercantilism related to international trade. Exporting was good and importing was bad because international trade was a zero-sum game. Exports deprived the enemy of something valuable, imports provided them with something valuable: markets and gold. The higher up the value-added chain were your exports, the more the other was deprived. It was important not to sell raw materials that might support the productive efforts of the potential enemy or to permit the export of technical knowledge. Thus, the emigration of artisans was high treason. On the other hand, it was important not to be dependent on foreigners for raw materials because of the risk of being cut off in time of stress. Export manufactured goods but import as little as possible and strive for self-sufficiency in essential inputs. What you do not have yourself, control through colonies. Historically, foreign investment was not an issue, but we can hypothesize a mercantilist position by extension from these principles. Foreign control of any industry would be, by definition, a disaster, even though there might be a gain of technology.

The National Policy

Canada's first indigenous trade policies as they evolved in the three decades following the repeal of the Corn Laws through Confederation to MacDonald's National Policy displayed a remarkable continuity with the past. In one sense, these policies were a reaction against imperialist mercantilism. Yet in their own right, they were the embodiment of an indigenous mercantilism. The "principles" of mercantilism were not the issue, but who administered them was. Perhaps this was a perfectly predictable and quite understandable reaction to the realities of a new economic environment, including the implications of major tecnological changes in transportation and communication. It was the age of the railway and the telegraph as well as the age of steam transport by sea. But the significant fact was that the relative cost of overland shipments fell dramatically.

In our present context, however, what is remarkable about our early trade policies is the persistence and the strikingly modern character of the principles embodied in them. The national policy period, if we may call it that, lasted until World War Two. It is true that during this period there were substantial variations in trade policy. Thus, the 19th century romance of some Canadian policy thinkers together with the notion of reciprocal free-trade with the United States, were abandoned when Laurier lost the election of 1911 on the free-trade issue. In another vein, a British preferential tariff was introduced in the 1890s in an attempt to resist the growing importance of the United States in Canadian trade. It was a convenient instrument around which to initiate the Empire trade movement of the 1930s, and it helped to dampen the overall rise in the Canadian tariff level brought about by the R.B. Bennett tariff of 1933. Thus, it undoubtedly helped stimulate more trade than otherwise would have occurred during the 1930s, but it did not produce a large scale reorientation of Canadian trade. However, its evolution into the "most favoured nation" rate was important in the long-term. The effects and lessons of the Bennett tariff require much more analysis. Largely a response to the US Smoot-Hawley tariff, and hence in part a bargaining ploy, it did represent Canada's vigorous participation in the disruption of the world economy in that era--the effects of which lingered on for many years.

Nonetheless, in spite of these important variations, the themes established in our earliest trade policies remained intact, though they were applied with varying intensity from time to time. At the risk of excessive simplification, these themes can be briefly summarized as follows:

- there was a north-south geographical preoccupation bordering on economic integration, giving rise to fears of political integration.

This is not to say that other trading relationships became unimportant, only that the American relationship became dominant. At the outset, the reorientation of trade from the trans-Atlantic to the north-south axis was dramatic, and a direct response to technological change in transportation and the rapid development of American markets. From the outset, it also involved schizophrenic policy responses (reciprocity and protectionism) and political controversy among groups with divergent interests in expanding trade relations with the United States.

- There were frantic efforts to develop export markets for the products of Canadian resource industries because they were the obvious basis of immediate prosperity, while all the time there was great bemoaning of the fact that the contribution thus made to the industrialization of other nations occurred "at the expense of the industrialization of Canada".

- Hence, there emerged an equally serious concern about the "technological backwardness" of Canada, which led to the deliberate cultivation of domestic manufacturing behind high tariff walls as Canada sought to capture her share of the high technology industries of the day.

This began early. Thus, the Cayley-Galt tariffs of 1858-9 have proved to have been very subtle in providing effective protection; within a very few years the debate that was to culminate in the national policy tariff of 1879 had begun. If today, the minister responsible inadvertently read a hundred year old speech of Sir J. Rose, he would find familiar themes, and only the prose style would signal the date. Hence we have the beginning of the abiding paradox of Canadian trade policies: striving to increase exports of goods in which we had a comparative advantage while attempting to restrain imports of goods in which we had a comparative disadvantage.

- Interregional tensions created by the divergence of interests over commercial policies began to assume regional characteristics: Residents of some regions perceived that their real incomes were dependent on free trade that promoted the production and export of the products of resource industries as well as low-cost imports. Residents of other regions perceived a dependence of their real incomes on the protection of production in "high technology" manufacturing industries.
- Restrictions on international trade were resorted to as a response to periodic episodes of unemployment.

The Cayley-Galt and National Policy tariffs can, in a sense, be seen as reactions to the depression and, Benett's tariffs of the 1930s were certainly in that vein.

Post-World War Two

In the post-1945 world, Bretton-Woods and Canada's participation in the GATT are generally thought to mark a turning point in Canadian trade policy. We argue that this is not so. It is true that Canada participated in the successive rounds of tariff negotiations and that significant reductions in many Canadian tariffs occurred as a result. A careful history of Canada's participation in these negotiations has yet to be written. However, both from contemporary reports and from the results, it is clear that the Canadian position was almost consistently that Canada is a "special case" whose delicate manufacturing sector requires special nurturing. We see no evidence of the abandonment of traditional policy themes. In this sense, the tendency towards trade liberalization in the 1960s was always more academic than real, and to the extent that it was real, it does not represent the norm against which current policy should be judged.

An important development has been the increased use of non-tariff barriers to restrict the inflow of imports.[26] These restrictions often replace tariffs with an arbitrary authority, whose terms of reference are almost exclusively interpreted from the point of view of industrial welfare rather than consumer welfare. Included among these non-tariff restrictions are the change in the source of valuation for tariff purposes, quota restrictions in footwear and textile products, and administrative delays at ports of entry. The effects of such measures are difficult to quantify, although the directional influence on Canadian income is perfectly predictable.

During the 1970s and the early 1980s, new economic pressures came to bear on Canada's international trade. Some of these pressures were of domestic origin, such as the slowing down of the rate of productivity growth. Some, such as the general influence of stringent monetary control in the US and Great Britain emanated from the wider world economy. Some, such as the "oil crisis" of the early years of the past decade were thrust with sudden force on an international trading order more vulnerable in retrospect than imagined at the time. Most of these economic pressures were of course related in some fashion.

In response to these, the Canadian federal and provincial governments brought down a series of measures and policies designed to alter both the patterns and levels of Canada's international trade. Often these were in the guise of industrial strategy, and they included attempts to influence the trade policies of other nations. While much of the effort involved the traditional tools of trade policy, new initiatives to manipulate domestic resource allocation to serve specific goals of trade policy were also implemented. The establishment of the Foreign Investment Review Agency, the Canadianization of the oil and petroleum industry, various labour market policies, as well as capital market provisions amongst others are all in some fashion related to the supposed performance of the international trade sectors of the economy. Some observers call for the implementation of an industrial strategy and the phrase "new national policy" is often heard.

Conclusions

This capsule history is far too sketchy to support any significant analysis. However, it is sufficient to make two points. As we seek an explanation for the persistent income gap, we should start with the observation that Canadian commercial policy has been essentially constant over most of the period. Indeed, as Young noted,[27] nominal tariff levels did not change much from the turn of the century until Bennett's tariff of 1933, and in 1939 they were at about the same level as in 1920. In the postwar period they have declined, but as we noted, the apparent degree of trade liberalization may be spurious. In the past decade, there has emerged incrementally a set of restrictive trade and trade-related policies that we identified earlier as representing the new mercantilism.

Tariffs and the Industrial Structure:
Product Diversity and Economies of Scale

While there had been many earlier discussions of the economic consequences of Canadian tariff policies, including some analyses of the impact of tariffs on the development of particular industries, the first major economic analysis was that of Marshall, Taylor and

Southard, and their classic book Canadian-American Industry appeared in 1935. Their major conclusions are familiar:

> Tariffs have been a factor in the Canadian-American branch plant movement for more than 50 years . . . stimulating the erection of new branch plants and the expansion of old ones, as their scope and severity have increased. . . .
> During the last few years tariffs have been of overwhelming importance in the branch plant movement.[28]

There was also the counterpart effect, where "branch plants come to have. . .a vested interest. . .in the tariff status quo".[29]

In his early research, John Young considered the implications of the branch plant movement for productivity in Canadian manufacturing, concluding that the small size of the Canadian market induced firms to design plants that would produce a wide range of products rather than specialize in a narrow range, and that:

> American firms with American management and what in many cases is in effect the equivalent of an American working force, producing for a market which in many cases has American tastes, find that highly mechanized production methods which are economical and profitable in America are not profitable in Canada.[30]

The tariff induces a lower level of productivity although, as Young noted, this applies only to manufacturing that is only "a piece of the economy, a fraction of a fraction".[31]

This theme was much more systematically examined in 1967 by Eastman and Stykolt, in The Tariff and Competition in Canada. Using a methodology made famous by Professor Joe Bain, they studied a range of major Canadian manufacturing industries, identifying for each the smallest plant size that was technologically efficient ("best practice technology") and the average sizes of plants in Canadian industries. Their conclusions are not surprising: for a very wide range of industries, Canadian manufacturing plants were seriously sub-optimal, and, while there are a number of explanatory factors, they concluded that "the policy instrument that most affects the size of the markets facing most manufacturing industries in Canada is the tariff".[32] (emphasis added) Eastman and Stykolt were skeptical about the relevance of foreign tariffs in this context, because "few Canadian manufacturing industries as now organized could export, even in the absence of foreign tariffs".[33]

This suggested serious difficulties from free trade with the United States. In what is probably the most important study on this topic by Canadian economists, Wonnacott and Wonnacott developed this theme in 1967 considering the problems and processes of industrial reorganization under free trade. After exploring the determinants of relative costs of production in manufacturing industries in various regions of Canada and the United States, with particular attention to the much neglected locational factors, they concluded that there was no inherent cost disadvantage to most manufacturing activities in Canada. Observable high costs were almost entirely a result of the failure or inability to take advantage of economies of scale in production, and hence can be traced back to commercial policies. The result is a powerful argument that Canada has much to gain from free trade. Two points must be emphasized, however:

- Economies of scale dictate increased specialization in manufactuirng activities, which is commonly referred to as rationalization of industry. Canada would not necessarily be involved in all manufacturing industries and Canadian manufacturing plants would produce a much narrower range of products.
- While there are gains to be made from the unilateral adoption of a free trade policy, the major gains are from free access to the United States market. The Wonnacott study thus made a strong case for bilateral or multilateral free trade, and a less strong, but nonetheless positive, case for unilateral free trade.

Subsequent research has reinforced the earlier conjectures about product diversity and economies of scale,[34] and the result of the Auto Pact with the United States is generally thought to provide very strong evidence of the possibilities for productivity increases through rationalization. However, the Wonnacott analysis remains highly controversial.[35] Yet, the results we presented in the last Section are striking. So are those of the recently published Harris and Cox study.[36] Unexploited economies of scale tend to be concentrated in those sectors that attract the highest degree of protection, although there are of course some exceptions.

In our opinion, the evidence overwhelmingly, and, to our knowledge, undisputedly points out that there are significant unexploited economies of scale in manufacturing. The next step in the argument is less accepted: that this is a major contributor to the productivity gap, and that it is primarily a consequence of tariff and other exclusionary trade policy, in Canada and the United States.

Technological Backwardness: Autonomous or Induced?

It has been said that the persistent income gap reflects the technological backwardness of Canada. Canada has relatively low productivity because Canadian industries do not develop and do not adopt "state of the art" technology. The proposition is stated most clearly in various works of the Science Council of Canada, but is also echoed in the popular press, by politicians, and by some leading international trade economists.

The evidence upon which the technological backwardness hypothesis is based is a statistical analysis of the performance of manufacturing firms in Canada with respect to research and development expenditures and the "high technology" content of production and exports. In what is probably still the best analysis of the role of technology in Canada's international trade, Bruce Wilkinson explored these issues in the context of the product cycle literature.[37] He demonstrated that while significant portions of Canadian exports embodied "high technology" (that is, they were human-capital intensive), Canada lagged behind significantly, both in the development of new technologies and in the adoption of technologies from abroad. This is the theme of a major research effort by the Science Council of Canada, including the study by Britton and Gilmour, which is rich in data and analysis and which has been extensively commented upon elsewhere.[38] The figures show a lower level of research and development expenditures as a proportion of

GNP in Canada than in many industrial countries and support Wilkinson's earlier analysis of the technological content of Canada's international trade. In addition to buttressing the case that Canada is technologically backward, these data have been used by governments--including provincial governments such as British Columbia and Ontario--to justify subsidies to "high tech" industrial research.

While there are problems of comparability over time and space, we do not question the "facts". The case for "technological backwardness" in these terms is reasonably well-documented. However, we must still ask: Why does it exist? Is it a problem per se?

It should be apparent that the results documented by Wilkinson and Britton and Gilmour are precisely the long-term results predicted by the conventional economic analysis of Canadian and American protective trade policies. It is one of the fundamental propositions of economics that different technologies are optimal in different circumstances, particularly when one considers the different relative factor prices and the different intended scales of operation. Thus, conventional economic analysis of the productivity gap is not inconsistent with the observation that Canadian firms do not develop and adopt "state of the art" technology: an engineer's concept of the "state of the art" is simply not appropriate in many Canadian manufacturing industries.

The essential point was made in an observation by John Young, quoted earlier:

> American firms with American management and what in many cases is in effect the equivalent of an American working force, producing for a market which in many cases has American tastes, find that highly mechanized production methods which are economical and profitable in America are not profitable in Canada.[39]

In the same vein, Don Daly observed that there is a productivity gap between the two countries because "it is profitable for Canadian plants to be less productive than plants in the United States".[40] Worth noting is that the only sector of manufacturing where productivity reaches levels similar to those of the US is the automobile industry, an industry that was rationalized under the aegis of the Auto Pact.

In contrast, the technological backwardness school finds the bête noir in foreign-controlled firms. Thus Wilkinson contrasts the "aggressiveness" of Canadian-controlled firms with the reticence of foreign-controlled firms, both in expanding export markets and in research and development,[41] and Britton and Gilmour come to even stronger conclusions. But why do the firms behave in this way? Is there a ubiquitous conspiracy? Is it rooted in non-profit maximizing behaviour? The theory is seriously underdeveloped.

Wilkinson has sagely asserted that "it would be imprudent. . .to place all blame for the inefficiency in Canadian manufacturing upon either the tariff structure or foreign--or domestic--firms."[42] However, we argue that the technological backwardness hypothesis and the policies derived from it implicitly take as given the economic and policy environment in which the firms are operating, including the effects of commercial policy. This is a fundamental error in analysis. Behaviour is induced by the environment; policy must be predicated on an understanding of these links, not on the raw evidence of the behaviour itself.

We do not believe in pervasive conspiracy theories, and we are unwilling to abandon the profit-seeking assumption that underlies conventional economic analyses of the behaviour of business firms. Needless to say, we find the evidence offered in support of a quasi-autonomous or foreign-controlled technological gap to be unconvincing and the policies predicated on this hypothesis to be dangerous--whether the policies are tariff protection or large-scale discriminatory subsidies to domestic research and development (R&D). Technology does not have to be indigenous to be appropriate. Indeed, as Daly and others have argued, the purchase of a required technology may be much more cost effective in terms of lost income than the investment in R&D facilities, and the payoff to research is highly stochastic unless it has clear applicability in an existing industry. All of the studies to the contrary notwithstanding, we see no evidence that Canadian industry in general or manufacturing in particular have been denied access to technology that would have been optimal in our economic environment.

In short, the conventional economic analysis attributes both the productivity gap and the so-called "technological backwardness" to the pervasive effects of protection (both in Canada and in the United States). Technological backwardness is not an autonomous factor explaining the income and productivity gaps: it is induced by policy. In this context, we also stress that while the direct effects of protection bear only on the protected manufacturing sector, the indirect effects are much more pervasive. By affecting the cost of inputs into other industries (an effect mitigated in some cases by the complex of draw-back and end-use provisions in the Canadian tariff), not only is negative "effective protection" created in those industries, but relative costs are also affected, and hence the appropriate production techniques are altered. Protection in manufacturing reduces productivity in the primary, transport, and service industries as well.

Employment and Regional Effects

The creation of employment has been a repeated objective of Canadian commercial policy. The meaning of this objective requires some interpretation, however.

In an insightful analysis, which, surprisingly has induced little further examination, John Dales attempted to establish a link between tariff policy, immigration, and population size.[43] It is possible that some such long-term concept of employment entered into tariff policy at various times. On a national level, we assume that this is not the issue today, although it does seem to enter the thinking of some provincial politicians from time to time.

Britton and Gilmour enunciate a different employment objective, and one that we fondly refer to as a Medical School Expansion Goal. Thus, Britton and Gilmour suggest:

> Each generation wishes to be involved in the most interesting and productive jobs that its intellect can command. Canada needs healthy manufacturing since it is an important source of jobs in management and in a wide variety of professional (especially technological) fields.[44]

By implication, the attractive jobs must be in Canada, so the traditional method of matching jobs and people through migration is no longer appropriate. The connection with the expansion of the UBC medical school is that it was predicted not on the basis of projected shortages of physicians, but on the fact that only a third of new physicians in the province are trained in British Columbia. The issue is not to produce the service at the least cost, but rather to provide attractive opportunities to the new generation and, incidentally, to provide increased demand for the highly-skilled of this generation.

We understand the notion that utility is attached to the characteristics of a job as well as to the characteristics of products consumed. Our economics suggests that jobs providing unusually high utility to incumbents should also be jobs that provide lower monetary incomes than would otherwise be necessary (to achieve a given "real income"). This does not appear to be what is advocated. Indeed, if we read between the lines, the argument seems to be that high incomes are necessary to attract people to the jobs (and to keep them in Canada). Perhaps you will excuse us if we suggest that the argument has a certain circularity and a strong self-serving element on the part of the scientific and technological community. To the extent that the argument has independent roots, these roots must be in mercantilist concepts of the national interest, and of what constitutes "good jobs" and "bad jobs".

The third concept of employment as an objective of commercial policy relates to the short-term: the reduction of unemployment. It may seem unduly harsh, in the present economic climate, to argue against this as a criterion for commercial policy. However, the apparent benefits in employment are short-term and frequently spurious; the long-term costs are easier to ignore, but serious nonetheless. We should not attempt to stimulate employment through protection of Canadian industries, whether they be "high tech" or labour intensive. Such polices build in long-term inefficiencies, invite foreign retaliation, and hence are fundamentally destructive to the liberal world economy on which Canada is so dependent for its prosperity in the both short- and long-term.

This argument may be dismissed as special pleading from a region known to benefit from free trade and also to contain few protected industries. However, we agree with Mackintosh's assessment of long ago: that the long-term effects on per capita income in the regions is much exaggerated, and hence too much emphasis is placed on the regional consequences of the tariff.[45] The reduction in real income is felt in all regions of Canada, even though the effects are most easily identified in regions such as British Columbia. While there are some longer-term regional consequences of protection, the major effects discussed in the literature relate to the short-term impact of changes in policy.

Conclusions: The Canadian Disease

The literature of international economics in recent years has diagnosed and labelled at least two national "diseases", the incidence of which, however, is not confined to their putative homes: the "British Disease" and the "Dutch Disease". We propose a third such ailment, the "Canadian Disease". Like its European counterparts, it is not peculiar to its attributed origin, Canada. Indeed, from time to time it has occurred in every country and in some countries it is present all of the time. However, we suggest that it is quintessentially Canadian. It occurs here in its "pure and concentrated essence". Canada was born with the germs in its national blood, the ailment has dominated discussions of national policy over the years, and, at the present time, it has developed in a particularly virulent form. Like many other diseases, it was well known in earlier history, where it masqueraded under a different name--mercantilism.

The Canadian disease is psychological. It involves a chronic national delusion, and perhaps a chronic national schizophrenia. The delusion is a continuous and deliberate depression of per capita income in Canada in the interests of the "long-term" well-being of Canadians. Somehow the "long-term" never arrives. The schizophrenic aspects arise from our desire for prosperity through participation in the world economy by doing what we do best, coupled with our drive to be an "advanced" economy, dominated by "high tech" manufacturing. The result has been a national penalty, which is perhaps not severe in historical perspective, but which is disturbing because it seems so pointless.

A recent mutant form of the disease involves complications that are not easy to define clinically: attitudes to foreign exchange rates, and to the US dollar in particular. In the 1960s, it was common to have industry spokesmen advocate fixed exchange rates. While many economists sang the praises of flexible exchange rates, "parity-psychology" was in general said to dominate public behaviour. The Canadian dollar should be at par with the US dollar. Depreciation is a sign of weakness, and appreciation a confirmation of the innately more serious sense of economic and moral purpose of a less frivolous people. Like all things Canadian, nothing in extremes was expected, and hence par would be the most likely long-term exchange rate.

Then Canadian industry discovered inflation. Inflationary wage increases could be absorbed by a depreciating exchange rate. Although the depreciation of the Canadian dollar increased the cost of imported intermediate goods, the demand for final goods proved, at least in the short-term, insensitive to the Canadian dollar price. Firms that did not participate in wage escalation paid the penalty in the form of labour unrest and the loss of workers to other firms. The foreign exchange rate had become a common property resource.

Of course, it was not manufacturing alone that found this convenient. The mutant strain of the Canadian disease spread, and in important export industries (like forest products) the rate of increase of unit labour costs was far above that in the same industries in the United States.

Moderation of the domestic inflation rate and the relative stability of the exchange rate in the range of 0.75 to 0.81 cents has been achieved in recent months--but at a terrible cost in terms of unemployment. Perhaps the contagious phase of the inflationary outbreak is over; the cost will nevertheless continue to be felt in many ways. What is vitally important, however, is that these costs not be aggravated by international trade policies and industrial strategies that perpetuate the destructive waste long after full recovery arrives.

In this paper we have attempted to make several points. First, we should be concerned about the objectives of our international trade policies. Naive classical notions that the measurement of a nation's welfare as the sum of individual real incomes have long gone by the board as we have placed increasing emphasis on the distribution of income. However, whether the issue is aggregate growth, individual welfare, or equitable distribution, command over goods and services--real incomes--remains the essential concern of long-term economic policy (externalities, including environmental externalities notwithstanding). An essentially mercantilist concept of the "national interest"--defined somehow in terms of bilateral or commodity specific trade balances, the proportion of exports that are "high tech", or the proportion of the labour force employed in high quality jobs--seem to us to be fundamentally destructive of the values that ought to be maximized. Indeed, it is not too bold to say that in the literature emanating from the Science Council, there is, not surprisingly, a large measure of self-serving special pleading on the part of the science establishment. In our opinion, we must not pursue technology for its own sake nor should we pursue it only with the view of what it can do for us. The appropriate guide in this matter is not the delusions of the Department of Industry, or those of the Science Council, but rather, the realities of the market place.

Canada has much to gain from multilateral free trade, mostly from the removal of foreign (particularly US) trade restrictions. To be realistic, multilateral free trade will probably not be achieved, at least in the short term. However, it should, nonetheless, be the consistent national objective. Canada should not be in the vanguard of international forces of protectionism; it should be leading the cause for freer trade. In this context, it is terribly unfortunate that we seek to use restrictions on international trade--often justified on grounds of equitable competition--as devices to increase employment. Such measures are fundamentally destructive of the international economy, and are measures that Canada can ill afford. That is one of the lessons of the depression of the 1930s and one of the lessons that our policymakers seem not to have learned, or at the very least, to have forgotten.

Notes

1. C. Pestieau and J. Henry, Non-Tariff Trade Barriers as a Problem in International Development: A Study in Two Parts.
2. See p. 37 of that report.
3. See Science Council of Canada, Annual Reports, especially "Technological Sovereignty", 1977.
4. Unless otherwise noted all trade data in this section are from the Statistics Canada CANSIM tapes or the Catalogue No. 65 series, the Canadian Statistical Review, or The Bank of Canada Review.
5. W. Marr and D.G. Paterson, Canada: An Economic History, 400.
6. R. Wonnacott, "The Canadian Content Proposals of the Task Force on the Automobile Industry", 1-9.
7. S. Reisman, The Canadian Automotive Industry: Performance and Proposals for Progress.
8. See Toronto Star 28 May 1982, p. 23.
9. See Government of Canada, Pacific Rim Opportunities Conference, Background Report (1980); K.A.J. Hay, Canadian Perspectives on Economic Relations with Japan; and other studies in this series.
10. The Economic Intelligence Branch, Economic Policy and Analysis, Department of Industry, Trade and Commerce report the same difficulties as we encountered for certain sectors, in a 1980 paper entitled "Manufacturing, Trade and Measures".
11. D. Burgess, "A Cost Minimization Approach to Import Demand Equations".
12. The disturbance vector U = (U1,U2. . .Un) is assumed to be generated according to a first-order autoregressive scheme
    $U^1_2 = U^1_1 R + e_2$
    where U is the error for the second observation of the demand equation for factor one and R is a NxN matrix of autocorrelation coefficients. The first-order error terms, e = (e2, e3. . .en) are normally and independently distributed. The matrix R is restricted to being diagonal so that there will be only one autocorrelation coefficient for each of the N regression equations. Thus are estimated error terms are allowed to be

both contemporaneously and temporally correlated.

13. In all cases the symmetry of the off diagonal coefficients is maintained so as to comply with economic theory.

14. Computer estimation involved first estimating the symmetry-constrained system with no correction for auto correlation. In the event that we could not accept the null hypothesis of no serial correlation, all subsequent estimations were performed using a non-linear Maximum Likelihood algorithm for a linear system of equations. The convergence criterion in all specifications was 0.01 unless questions regarding the reliability and accuracy of the results required a more rigorous tolerance.

15. H.C. Eastman and S. Stykolt, The Tariff and Competition in Canada.

16. E.R. Berndt and D. Wood, "Technology, Prices, and the Derived Demand for Energy".

17. M. Bliss, "The Evolution of Industrial Policies in Canada: An Historical Survey".

18. J.H. Young, "Comparative Economic Development: Canada and the United States", 85.

19. J.H. Dales, The Protective Tariff in Canada's Development, 111.

20. Ibid., 116-29.

21. Young, "Comparative Economic Development", 85.

22. D. Walters, Canadian Growth Revisited 1950-1967; and N.H. Lithwick, Economic Growth in Canada: A Quantitative Analysis.

23. Young, "Comparative Economic Development".

24. D. Daly, "The Continuing Debate about Freer Trade and its Effects: A Comment".

25. B.W. Wilkinson, "Canada-US Free Trade and Some Options".

26. F. Lazar, The New Protectionism: Non-Tariff Barriers and their Effects on Canada.

27. J. Young, Canadian Commercial Policy.

28. H. Marshall et al., Canadian-American Industry, (Toronto: Ryerson, 1936), 202 and 201.

29. Ibid., 275.

30. Young, "Comparative Economic Development", 91.
31. Ibid., 92.
32. Eastman and Stykolt, Tariff and Competition in Canada, 102.
33. Ibid., 106.
34. See D. Daly, B. Keys and E. Spence, Scale and Specialization in Canadian Manufacturing; and R. Caves, Diversification, Foreign Investment and Scale in North American Manufacturing Industries.
35. See J. Britton, "Locational Perspectives on Free Trade for Canada"; and Wilkinson, "Canada-US Free Trade".
36. R. Harris and D. Cox, Trade, Industrial Policy and Canadian Manufacturing.
37. See B. Wilkinson, Canada in the Changing World Economy, 68-76.
38. J. Britton and J. Gilmour, The Weakest Link: A Technological Perspective on Canadian Industrial Underdevelopment. See also D. Daly, Canada's Comparative Advantage.
39. Young, "Comparative Economic Development", 91.
40. Daly, Keys and Spence, Scale and Specialization, 58.
41. Wilkinson, Canada in the Changing World Economy, 73-76.
42. Ibid., 77.
43. Dales, Protective Tariff in Canada's Development.
44. Britton and Gilmour, Weakest Link, 65-6.
45. W. Mackintosh, The Economic Background of Dominion-Provincial Relations.

Table 1: Canadian Automobile, Truck and Parts Trade: Selected Years 1968-1960

	Exports ($1,000,000's)					Imports ($1,000,000's)				
	1968	1971	1974	1977	1980	1968	1971	1974	1977	1980
Passenger automobile and chassis	1,357	2,065	2,649	4,285	4,608	1,064	1,304	2,023	3,356	4,414
Truck, truck tractor and chassis	389	525	864	2,081	2,416	167	314	827	1,010	1,133
Vehicle engine and engine parts	247	442	461	945	455	354	459	720	1,437	1,658
Vehicle parts, other than engine	556	979	1,490	2,663	3,010	1,323	1,885	3,086	5,324	5,947
Total transportation equipment	3,246	4,593	6,271	11,339	13,373	3,359	4,596	8,400	12,675	16,412
Total import/export (all commodities)	13,220	17,397	31,675	43,684	74,446	12,358	15,608	31,692	42,332	69,274
Automobile and truck as per cent of transport equipment	53.8%	56.4%	56.0%	56.2%	52.5%	36.7%	35.2%	33.9%	34.5%	33.8%
Automobile and truck as per cent of total import/export	13.2%	14.9%	11.1%	14.6%	9.4%	10.0%	10.4%	9.0%	10.3%	8.0%
Engine and engine parts as per cent of transport equipment	7.6%	9.6%	7.4%	8.3%	3.4%	10.6%	10.0%	8.6%	11.3%	10.1%
Engine and engine parts as per cent of total import/export	1.9%	2.5%	1.5%	2.2%	0.6%	2.9%	2.9%	2.3%	3.4%	2.4%
Engine, engine parts and vehicle parts as per cent of transport equipment	24.7%	30.9%	31.1%	31.8%	25.9%	49.9%	51.0%	45.3%	53.3%	46.3%
Engine, engine parts and vehicle parts as per cent of total import/export	6.1%	8.2%	6.2%	8.3%	4.7%	13.6%	15.0%	12.0%	16.0%	11.0%

Sources: Summary of External Trade, Statistics Canada (65-001).
Exports by Commodity, Statistics Canada (65-004).
Imports by Commodity, Statistics Canada (65-007).
Summary of Exports, Statistics Canada (65-002).
Summary of Imports, Statistics Canada (65-005).

Table 2: Merchandise Exports and Imports, Annually, 1971-83

	Merchandise Exports $ billions	Export Indices 1971 = 100 Price	Merchandise Imports Volume	Import Indices 1971 = 100 $ billions	Price	Volume
1971	17.8	100.0	100.0	15.6	100.0	100.0
1972	20.2	103.4	109.4	18.7	102.3	116.9
1973	25.4	117.9	121.1	23.3	110.1	135.7
1974	32.4	156.3	116.5	31.7	135.9	149.5
1975	33.3	173.1	108.1	34.7	157.4	141.3
1976	38.5	177.2	121.0	37.5	157.6	152.4
1977	44.6	188.6	131.9	42.3	176.9	153.2
1978	53.2	205.3	145.0	50.1	200.9	158.1
1979	65.6	248.2	147.6	62.9	229.2	175.7
1980	76.2	290.9	145.7	69.3	267.7	165.7
1981	83.8	309.5	149.7	79.5	298.6	170.4
1982	84.5	310.9	149.9	67.9	303.7	143.2
1983	90.9	-	-	75.7	-	-

Source: *Bank of Canada Review*, Ottawa, February 1984, pp. S-136/7.

Note

Where no figures appear, none were available.

Table 3: Composition (%) of Merchandise Exports by Country or Area of Destination, Selected Years 1968-80

	1968	1971	1974	1977	1980
United States	67.8	64.5	66.1	69.8	63.3
Central America	1.9	2.0	2.0	1.8	2.0
South America	2.1	2.2	2.8	2.6	3.1
Oceania	1.7	1.3	1.2	1.1	1.1
Australia	1.4	1.0	1.0	0.9	0.9
Asia	7.5	7.8	10.3	8.5	9.9
Republic of China	1.2	1.1	1.3	0.8	1.2
Japan	4.5	4.7	6.7	5.7	5.8
Africa	0.8	0.9	1.2	1.1	1.4
Middle East	0.4	0.8	1.0	1.6	1.5
USSR and Eastern Europe	1.0	1.0	0.6	1.5	2.8
EEC - Western Europe	14.8	14.3	12.6	10.6	12.6
France	0.6	0.9	1.0	0.8	1.3
West Germany	1.7	1.8	1.7	1.7	2.2
United Kingdom	9.0	7.9	6.0	4.4	4.3
Non-EEC Western Europe	1.9	2.2	2.1	1.5	2.2

Source: CANSIM

Table 4: Composition (%) of Merchandise Imports by Country or Area of Origin, Selected Years 1968-80

	1968	1971	1974	1977	1980
United States	73.3	70.2	67.5	70.4	70.1
Central America	1.7	1.5	1.3	1.5	1.5
South America	3.8	3.4	5.1	4.3	4.3
Oceania	0.9	1.1	1.3	1.0	1.0
Australia	0.6	0.8	1.0	0.8	0.7
Asia	4.7	7.1	6.9	7.4	7.3
Republic of China	0.2	0.2	0.2	0.2	0.2
Japan	2.9	5.1	4.5	4.2	4.1
Africa	0.9	1.2	1.4	0.9	0.8
Middle East	0.8	0.9	4.1	3.6	4.4
USSR and Eastern Europe	0.7	0.6	0.6	0.5	0.5
EEC - Western Europe	11.3	11.6	9.6	8.6	8.1
France	1.0	1.4	1.2	1.2	1.1
West Germany	2.4	2.7	2.4	2.3	2.1
United Kingdom	5.7	5.4	3.6	3.0	2.9
Non-EEC Western Europe	2.0	2.4	2.2	2.0	2.1

Source: CANSIM

Table 5: Merchandise Trade by Commodity Group, 1980 (millions of dollars)

Commodity Group	Domestic Exports	Commodity Group	Imports
Live Animals	254.0	Live Animals	112.9
Food, Feed, Beverages	8,009.1	Food, Feed, Beverages	4,689.8
Meat & Fish	1,772.8	Meat & Fish	307.7
Cereals & Preparations	4,834.6	Fruit & Vegetables	1,396.4
Others	2,997.2	Others	2.985.7
Crude Materials, Inedible	14,759.4	Crude Materials Inedible	11,344.5
Metal Ores, Concentrates	4.209.7	Seeds & Fibres	472.2
Crude Petroleum	2,899.1	Ores & Concentrates	717.2
Natural Gas	3,983.8	Coal	811.2
Others	3,666.8	Crude Petroleum	6,919.1
		Others	2,424.8
Fabricated Materials, Inedible	29,344.9	Fabricated Materials, Inedible	12,708.3
Wood and Paper	12,092.7	Wood and Paper	389.9
Textiles	234.0	Textiles	1,276.0
Chemicals	2,031.6	Chemicals and Plastics	2,257.9
Iron and Steel	2,041.7	Iron and Steel	1,414.8
Non-ferrous Metals	6,070.0	Non-ferrous Metals	2,580.6
Others	6,874.9	Others	4,789.1
End-Products, Inedible	21,850.5	End-Products, Inedible	39,656.3
Industrial machinery	2,181.4	General Purpose Machinery	1,407.8
Agricultural Machinery	876.0	Special Industrial Machinery	5,344.0
Transportation Equipment	14,397.7	Agricultural Machinery	2,092.0
Other Equipment	1,975.7	Transportation Equipment	18,551.2
Personal & Household Goods	620.0	Other Equipment	5,839.4
Others	1,799.9	Personal & Household Goods	2,667.7
		Misc. End Products	3,654.2
Total[a]	74,446.0	Total[a]	69,273.8

Source: Canada, Summary of External Trade, No. 65-001, Statistics Canada, Ottawa, various issues.

Note

a. balancing items have been omitted.

Table 6: Composition (%) of Merchandise Exports (Current $s) by Industry of Origin, 1968-80

Industry	1968	1971	1974	1977	1980
Agriculture	8.0	9.2	10.2	7.7	8.2
Forestry	0.5	0.4	0.2	0.2	0.3
Hunting, Trapping & Fishing	1.4	1.1	0.9	1.3	1.2
Mining & Quarries (including oil wells)	16.4	16.4	22.3	18.2	17.9
Food Industries	2.9	2.7	2.3	2.7	2.7
Beverages (including alcoholic)	1.2	1.1	0.7	0.7	0.6
Rubber & Allied Products	0.5	0.4	0.3	0.4	0.6
Leather Products	0.1	0.1	0.1	0.1	0.1
Textile Industries	0.4	0.5	0.4	0.3	0.3
Clothing & Knitted Wear	0.3	0.5	0.4	0.3	0.3
Wood Products	6.0	5.6	4.8	6.4	5.3
Furniture & Fixtures	0.2	0.2	0.2	0.2	0.3
Paper & Allied Products	13.1	11.9	12.8	11.5	11.6
Printing & Publishing	0.1	0.2	0.2	0.2	0.3
Primary Metal Products	12.2	9.9	8.8	8.2	10.9
Metal Fabricating	0.7	0.8	0.9	0.8	1.0
Machinery (exc. electrical)	4.3	4.7	4.8	5.2	5.7
Transportation Equipment	23.7	26.3	20.3	25.9	17.7
Electrical Machinery	2.0	1.7	1.6	1.3	1.8
Non-Metal. Mineral Products	0.5	0.6	0.6	0.6	0.6
Petroleum & Coal Products	0.4	0.7	1.9	1.5	3.1
Chemical & Allied Products	3.0	3.2	3.3	4.2	5.5
Misc. Manufacturing	1.7	1.5	1.4	1.3	2.5
Electricity	0.1	0.3	0.6	0.9	1.1
Special Transactions	0.3	0.2	0.2	0.2	0.3
Rounding Error Correction	0.0	-0.2	0.2	-0.3	+0.1
All Industries	100.0	100.0	100.0	100.0	100.0

Table 7: Composition (%) of Merchandise Imports (Current $s) by SIC Industry, 1968-80

Industry	1968	1971	1974	1977	1980
Agriculture	4.7	4.5	5.0	3.8	3.9
Forestry	0.2	0.2	0.2	0.2	0.1
Hunting, Trapping & Fishing	0.4	0.5	0.6	0.7	0.7
Mining & Quarries (including oil wells)	6.8	6.3	10.7	10.8	14.6
Food Industries	4.0	3.8	3.7	4.5	3.5
Beverages (including alcoholic)	0.2	0.2	0.2	0.2	0.2
Rubber & Allied Products	0.6	0.7	0.4	0.4	0.4
Leather Products	0.7	0.8	0.6	0.8	0.6
Textile Industries	2.7	3.2	2.6	2.1	1.9
Knitted Products	0.4	0.5	0.5	0.6	0.4
Clothing Industries	1.4	1.4	1.4	1.6	1.3
Wood Products	0.8	0.7	1.1	0.9	0.7
Furniture & Fixtures	0.7	0.6	0.9	0.9	0.7
Paper & Allied Products	1.1	1.2	1.2	1.1	1.0
Printing & Publishing	1.7	1.7	1.2	1.3	1.3
Primary Metal Products	4.2	4.4	5.4	3.0	5.4
Metal Fabricating	5.2	5.5	5.2	5.1	4.7
Machinery (exc. electrical)	13.5	13.2	12.4	12.1	13.2
Transportation Equipment	28.8	29.3	26.6	29.8	23.5
Electrical Machinery	5.4	6.4	5.8	6.1	7.2
Non-Metal. Mineral Products	1.2	1.2	1.2	1.2	1.2
Petroleum & Coal Products	1.7	1.4	1.2	0.7	1.0
Chemical & Allied Products	5.3	5.3	5.6	5.4	5.3
Misc. Manufacturing	6.7	6.5	6.0	6.5	6.9
Electricity	0.1	0.1	0.0	0.0	0.0
Special Transactions	2.1	1.1	0.9	1.0	1.1
Rounding Error Correction	-0.6	-0.4	-0.6	-0.8	-0.8
All Industries	100.0	100.0	100.0	100.0	100.0

Table 8: Classification Scheme for Manufacturing Industries Under Study

Industry Title	SIC	I/O m	I/O l
Food & Beverage Industries	501	8	16-32
Rubber & Plastics Industries	503	10	35-38
Leather Industries	504	11	39-42
Textile Industries	505	12	43-55
Knitting Industries	506	13	56-57
Clothing Industries	507	14	58
Wood Industries	508	15	59-64
Furniture & Fixture Industries	509	16	65-68
Paper & Allied Industries	510	17	69-72
Primary Metal Industries	512	19	75-82
Metal Fabricating Industries	513	20	83-91
Transportation Equipment Industries	515	22	96-102
Electrical Products Equipment Industries	516	23	103-110
Non-metallic Mineral Products Industries	517	24	111-120
Petroleum & Coal Products Industries	518	25	121-122
Chemical & Chemical Products Industries	519	26	123-130

Note

The SIC numbers correspond to those set out in the 1970 Classification. The I/O industry aggregation numbers are those corresponding to the m-level and l-level sequences. It is at the l-level that it was possible for the imported intermediate goods to be identified and reclassified from the Standard Commodity Classification scheme to the Standard Industrial Classification.

Table 9: Log-Likelihood Values

Sic	Spec 1	Spec 2	Spec 3	Spec 4	Spec 5
501	499.5	513.2 (59)	504.9 (50)	444.3 (60)	495.1 (48)
503	483.9	539.3 (62)	535.3 (63)	471.6 (76)	537.2* (58)
504	528.3	615.8 (200)	604.4 (100)	510.2 (100)	601.3 (75)
505	452.4	531.8 (72)	529.3* (100)	429.5 (100)	529.1 (57)
506	353.1	479.4 (200)	465.5 (100)	394.2 (100)	460.8 (100)
507	576.8	648.7 (59)	638.2* (53)	556.9 (56)	634.3 (100)
508	452.2	502.4 (43)	496.8* (49)	434.9 (85)	493.2 (100)
509	496.2	541.3 (49)	535.9* (58)	481.5 (63)	532.4 (51)
510	506.8	541.8 (49)	536.4 (57)	460.5 (73)	536.4 (54)
512	325.9	369.4 (56)	360.8 (62)	315.3 (74)	355.6 (62)
513	577.9	663.6 (95)	659.7 (82)	577.4 (100)	656.2 (57)
515	419.8	445.6* (44)	442.2* (53)	348.8 (74)	423.5 (46)
516	562.3	623.5* (86)	619.4 (56)	544.2 (74)	618.9 (55)
517	412.2	444.4 (106)	440.5 (52)	350.7 (68)	432.6 (59)
518	199.2	239.4* (41)	232.5 (47)	206.5 (71)	231.9 (75)
519	378.7	466.7 (200)	443.3 (100)	367.9 (93)	456.8 (77)

Notes

The number of iterations required for convergence are noted parenthetically.

The asterisk (*) indicates that the convergence criterion was set at .001 rather than the standard .01. This was necessary to ensure that the covariance matrix did not collapse.

Table 10: Log-Likelihood Tests

Sic	No Auto	ZFS	CRTS	ZTC
501	27.35*	16.37*	137.74*	36.25*
503	110.68*	8.14	135.44*	4.22
504	174.99*	22.85*	211.20*	28.95*
505	158.78*	5.08	204.67*	5.61
506	252.52*	27.63*	170.34*	37.04*
507	143.91*	20.95*	183.67*	28.79*
508	100.43*	11.27***	135.14*	18.46*
509	90.27*	10.71***	119.75*	17.89*
510	70.03*	10.90*	162.63*	10.79**
512	87.12*	17.20	108.52*	27.87*
513	171.29*	7.84	212.30*	14.78*
515	51.75*	6.88	193.56*	44.21*
516	122.48*	8.20	158.62*	9.16***
517	64.35*	7.86**	187.33*	23.70*
518	80.25*	13.80*	65.74*	14.76*
519	175.99*	46.64*	197.35*	19.81*

Notes

*	-	reject the null hypothesis at the .99 level
**	-	reject the null hypothesis at the .95 level
***	-	reject the null hypothesis at the .90 level

Table 11: Autocorrelation Coefficients (rho)

Sic	Labour	Capital	Imports	Energy
501	-.2183***	.3441	.4134	.3552
503	.67078	.9333	.6237	.5645
504	.4849	.9959	.6565	.6968
505	.8264	1.00	.6928	.5055
506	.7795	.9956	.6393	.3323*
507	.3253*	.8976	.4897	.6674
508	.6618	.8811	.6721	.6535
509	.7819	.9282	.6311	.4835
510	.5726	.8570	.2690***	.4172
512	.0209***	.5916	.8309	.5991
513	.8265	.9754	.6712	.3884*
515	.6139	-.4244	.5063	.1694***
516	.8399	.7463	.6895	.5126
517	.8386	.4277	.5060	.5723
518	.3816	.8033	.5029	.6524
519	.1333***	.9909	.2805*	.4223

Notes

* - insignificant at the .99 level
** - insignificant at the .95 level
*** - insignificant at the .90 level

Table 12: Scale Coefficients: Models 2 & 3

Sic	No.	Labour	Capital	Imports	Energy
501	2	-.000117	-.007955	-.000812	-.000052
	3	-.000116	-.008202	-.000792	-.000054
503	2	-.000716	-.003420	-.002073	-.000155
	3	-.000662	-.34202	-.002124	.000151
504	2	-.005875	-.005487	-.013358	-.000187
	3	-.005834	-.054733	-.013443	-.000215
505	2	-.001110	-.042100	-.007508	-.000217
	3	-.001085	-.042268	-.007458	-.000211
506	2	-.018980	-.006989	-.020310**	-.000189*
	3	-.001790	-.006963	-.002190**	-.000266
507	2	-.001235	-.006309	-.004105***	-.000019
	3	-.001230	-.006315	-.004030***	-.000020
508	2	-.000628	-.003959	-.001417	-.000081
	3	-.000674	-.003952	-.001355	-.000085
509	2	-.001957	-.002860	-.007489	-.000117
	3	-.001965	-.002862	-.007557	-.000120
510	2	-.000220	-.003835	-.000078	-.000023
	3	-.000232	-.003827	-.000084	-.000217
512	2	-.000233	-.002574	-.003393	-.000213
	3	-.000255	-.002639	-.003280	-.000220
513	2	-.000314	-.009307	-.001866	-.000432
	3	-.000311	-.009280	-.001883	-.000048
515	2	-.000206	-.009739	-.006284	-.000032
	3	-.000210	-.009842	-.006143	-.000033
516	2	-.000382	-.008477	-.003324	-.000028
	3	-.000377	-.008469	-.003331	-.000027
517	2	-.000477	-.48877	-.001891	-.000872
	3	-.000469	-.004910	-.001660	-.000930
518	2	-.001601	-.371910	-.008239***	-.001116
	3	-.001655	-.370510	-.005353***	-.001140

Notes

* - insignificant at the .99 level
** - insignificant at the .95 level
*** - insignificant at the .90 level

Table 13: Technology Coefficients: Models 2 & 3

Sic	No.	Labour	Capital	Imports	Energy
501	2	.104120***	.384470	-.057098	.000826
	3	.000883	.404220	-.080185	.001029
503	2	-.003967***	.435800***	-.005778***	.034406***
	3	.000773***	.433540***	-.109190***	.004136
504	2	-.022140	-1.2686	-.120820	.000101***
	3	-.010131	-.794190	-.124140	-.000147***
505	2	-.009160*	.633140**	.008745***	.001829***
	3	-.008346***	-1.234000***	.010316***	-.000006***
506	2	-.038010	-4.8620	-.116070*	.001170
	3	-.030602*	-5.6487*	-.118770*	-.000020***
507	2	-.002809*	.085890	-.243770	.000292
	3	-.002525*	.084531	-.245230	.000323
508	2	.006160***	1.2657	-.031910	.007615
	3	.008249	1.2388	-.036540	-.007941
509	2	-.002733***	.129230***	-.146590	.000962
	3	-.002663***	.177140**	-.145280	.000968
510	2	.000612***	.660370	-.002493***	.009697
	3	.001780***	.697590	-.000114***	.009040
512	2	.002684*	1.1377	-.283180	.010296
	3	.003899	1.1140	-.283590	-.006942*
513	2	-.000319***	-.127680***	-.049700	.001362
	3	-.000033***	-.128030***	-.050736	.001257
515	2	.003573***	.311750	-.402820	.001016
	3	.003739*	.312760	-.411020	.000727
516	2	-.005175***	.183230	-.039694***	.000258***
	3	-.005378*	.183640	-.040454***	.000119**
517	2	-.004571***	.727482	-.048940	.011345*
	3	-.001789***	.727960	-.052396	.009598*
518	2	.004231*	3.1141	-.255970*	.022780
	3	.004468	3.7819	-.562780	.027350

Notes

*	-	insignificant at the .99 level
**	-	insignificant at the .95 level
***	-	insignificant at the .90 level

Table 14: Significance of Technology Coefficients

Sign and Significance	Labour	Capital	Imports	Energy
Specification II				
positive				
at 1 %	0	9 (8)	0	10
at 5 %	2	0 (0)	0	1
at 10 %	0	1 (0)	0	0
at 10 % +	2	10 (8)	0	11
negative				
at 1 %	2 (2)	2	9	0
at 5 %	2 (1)	0	2	0
at 10 %	0 (0)	0	0	0
at 10 % +	4 (3)	2	11	0
insignificant				
positive	4 (4)	2 (1)	1 (0)	4 (1)
negative	5 (3)	1 (1)	3 (1)	0 (0)
TOTAL	9 (7)	3 (2)	4 (1)	4 (1)
Specification III				
positive				
at 1 %	4	9 (8)	0	8 (7)
at 5 %	1	0 (0)	0	1 (1)
at 10 %	0	1 (1)	0	1 (0)
at 10 % +	5	10 (9)	0	10 (8)
negative				
at 1 %	1 (1)	1	10	1
at 5 %	3 (2)	1	1	1
at 10 %	0 (0)	0	0	0
at 10 % +	4 (3)	2	11	2
insignificant				
positive	2 (1)	1 (0)	1 (0)	0 (0)
negative	4 (3)	2 (1)	3 (1)	3 (2)
TOTAL	6 (4)	3 (1)	4 (1)	3 (2)

Note

Bracketed terms are cell counts, excluding sectors 503, 505 and 516 for which zero technological change could not be rejected. We have noted only those instances where cell counts are changed by this exclusion.

Table 15: Scale Coefficients: Models 2 & 3

Sic	No.	Labour	Capital	Imports	Energy
501	2	.17541	9.9778	.69551	.070764
	3	.21056	10.472	1.0282	.071664
503	2	.31375	8.6894	.60644	.04574***
	3	.17779	8.6923	.51030	.03852
504	2	.58436	40.219	1.1676	.02371***
	3	.65005	20.238	1.2346	.02271
505	2	.37870	13.090	2.1299	.048668
	3	.39728	35.536***	2.0282	.078195
506	2	1.3803	130.66	1.5764	.017750*
	3	1.5937	173.60***	2.0462	.028380
507	2	.44403	1.6527	2.6140	.003760
	3	.43136	1.6679	2.5886	.005654
508	2	.30546	12.085	.64708	.008586
	3	.31100	12.1590	.57919	.03397
509	2	.33038	4.6413	1.4598	.01028***
	3	.37304	4.5724	1.6576	.020254
510	2	.17621	26.722	.013804**	.26351
	3	.23066	26.550	.048348	.27659
512	2	.25942	19.026	3.1357	.1270
	3	.23100	19.134	2.9461	.19737
513	2	.25022	9.2483***	1.4335	.0215
	3	.26766	9.1794	1.3817	.03325
515	2	.21463	9.2181	7.5546	.02482*
	3	.23864	9.0215	7.2508	.03381
516	2	.27823	5.5341	2.0591	.015554
	3	.30413	5.5476	2.0787	.02002
517	2	.18971	15.661	.50831	.24678
	3	.21731	15.904	.76533	.31436
518	2	.19793	47.947	.85367***	.14359
	3	.23103	48.786	2.9072	.12873

Notes

* - insignificant at the .99 level
** - insignificant at the .95 level
*** - insignificant at the .90 level

Table 16: Significance of Cross-price Coefficients

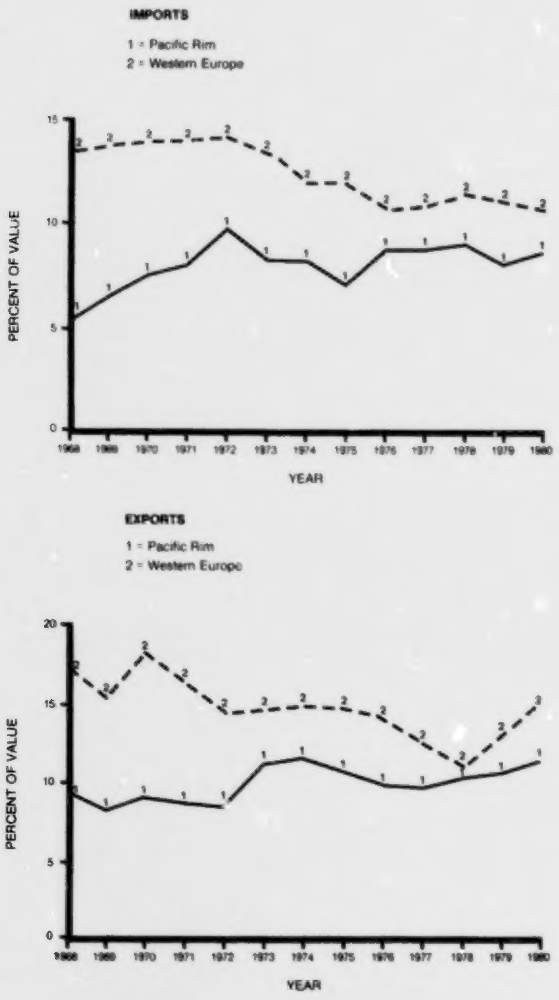
cross-price coefficient	positive	negative	signif.[a]
joint factor substitution			
labour/capital	4	2	1
labour/imports	4	2	2
labour/energy	5	1	2
capital/imports	4	2	2
Capital/energy	3	3	3
imports/energy	11	1	2
no joint factor substitution			
labour/capital	6	3	0
labour/imports	5	4	1
labour/energy	9	0	0
capital/imports	5	4	0
capital/energy	2	7	1
imports/energy	8	1	0

Note

a. significantly different from zero at the 5 per cent level or better. There are six sectors for which zero factor substitutability could not be rejected: SIC 501, 504, 506, 507, 512, and 518. These constitute the first grouping in the table. The remaining sectors (SIC 503, 505, 508, 509, 510, 513, 515, 516, and 517) are those for which factor substitution could be rejected at the 5 per cent level or better. Once again, SIC 519 is excluded.

FIGURE 1

Percentage Value of Canadian Merchandise Imports and Exports by Area, Western Europe and Pacific Rim, 1968-80



SOURCE: CANSIM data

Appendices

Appendix A: Imported Intermediate Goods

As noted in the text, the imported intermediate goods series required a procedure of disaggregation, reclassification and reaggregation along SIC categories. The details are too lengthy to delve into here, but briefly, merchandise imports from all countries, by commodities (Statistics Canada 65-007), based of the Standard Commodity Classification were disaggregated to the M level of the Statistics Canada input-ouput tables. The correspondence of the disaggregated input-output/SCC classifications along with the correspondence of the input-output/SIC classifications made it possible to reaggregate allocating imports by industry rather than by commodity class. Furthermore, at the disaggregate level the imports can be reaggregated keeping track of the two-digit level SCC so that even though imports are recategorized according to industry they can be classified according to end-use and level of fabrication within that industry. See Statistics Canada 12-501, 12-503, 12-508 and 12-512 for the required classification schemes. The Statistics Canada Current Weighted Paasche import price index (1971=100) by commodities was aggregated to the level of imported intermediate goods using the ratio of the current value of the imports of commodity I to the total value of all intermediate imports as the appropriate (current) weighted scheme.

Appendix B: Data

Labour

The quality of labour input is measured as the total person-hours worked per quarter adjusted so as to account for annual vacations. The quantity series was calculated according to the formula

TMHi = EMi x (AWHi x 4 x (50/52)

TQHj = ETMHi, i = 1, 2, 3 j = 1, 2. . .44

where EMi is total monthly employment by SIC industry (Statistics Canada 72-002), AMHi is average weekly hours by SIC industry (Statistics Canada 72-002). The weighting factory (4 x (50/52) adjusts for two week annual vacation. This is the formulation suggested by

Woodland, (1972). The wage rate series was constructed by averaging the Statistics Canada monthly series of Average Hourly Earnings (72-002) over quarters.

Capital

The capital stock series was constructed by linearly interpolating the mid-year net capital stock in millions of 1971 dollars available from Statistics Canada 13-213 and 13-211. Statistics Canada uses the "perpetual inventory" method in calculation of all capital stock and flow data. Calculations of net capital stocks are made by applying a "straight-line" depreciation formula to the gross stock estimates.

The rental rate was calculated according to the now familiar approach of Jorgensen and Stephenson (1967). The price index, PI was calculated by adjusting the Statistics Canada's Price Index of Construction, Machinery and Equipment from its 1968 = 100 base to a 1971 = 1.0 base. This series, like that for the wage rate is available on a monthly basis. The McLeod, Weir, Young average (40) bond yield is available from the Bank of Canada Review databanks in Cansim. Both of these series are monthly in frequency so that quarterly averages were constructed for the purposes of this study. The effective tax rates were taken Statements 15 and 16 of Statistics Canada's Selected Financial Statistics (61-208) and are measured as federal and provincial income taxes payable expressed as a percentage of book profits before taxes. The capital cost allowances were constructed as a weighted average of the capital cost allowance rates set out in table 12 of Statistics Canada 61-208 where the weights are calculated from table 9 of the same document. These weights are the current value of allowable capital cost allowance across all classes for the year in question. The construction of the depreciation rate follows Woodland (1972) and is decribed above.

Energy

Energy consumption and expenditure statistics for the manufacturing sector and its component industries can be found in Statistics Canada 57-506. Price per unit of fuel is derived by dividing total expenditure by energy type by consumption of that fuel. This data only available on an annual basis. The assumption made in this study in conversion to quarterly statistics is that energy consumption varies directly with capacity utilization rates (Statistics Canada 11- 001). The procedure used to facilitate this transformation was to normalize quarterly capacity utilization rates so that they summed to unity for each year. These normalized rates then served as weights by which annual consumption was allocated to quarters. Admittedly, this smoothes out consumption fluctuations but in light of the fact that the only obvious alternative (given the paucity of more detailed data) is to distribute consumption equally over all quarters, the methods employed here must serve as a second-best measurement.

Output

Output is measured by quarterly Real Gross Domestic Product and is constructed by simply multiplying the 1971=100 based quarterly index series by the value of Real Gross Domestic Product for 1971.

Further information about the data is available upon request.

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4: CONFLICT OVER THE EXTRATERRITORIAL APPLICATION OF US ANTITRUST LAW: A CANADIAN PERSPECTIVE

J. Christopher Thomas

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CONFLICT OVER THE EXTRATERRITORIAL APPLICATION OF US ANTITRUST LAW: A CANADIAN PERSPECTIVE

Introduction

Perhaps no other legal issue has created as much friction in Canada-United States relations as the extraterritorial application of US antitrust law. An expansive jurisdictional claim by US courts has resulted in a situation where Canadians engaging in entirely lawful activities in Canada--perhaps with government approval or encouragement--are nevertheless subject to US antitrust enforcement if such activities are seen to have an adverse effect on US domestic or foreign trade and commerce. Understandably, the government of Canada views this state of affairs with some concern because Canadian laws and government policies may be called into question in US courts.

This article examines the present lack of consensus in international law as to detailed rules for determining the appropriate limits to a state's jurisdiction. It then traces the development of the US claim to jurisdiction over anti-competitive activity occurring beyond its national boundaries. A jurisdictional claim based on a legislative policy that is American in its origins and content and for which there are unduly narrow defences inevitably leads to diplomatic conflict. The Sherman Act, enacted almost a century ago to deal with domestic "trusts" engaged in by private business interests, is in many cases an inappropriate standard by which to judge business activities occurring outside the United States.

While antitrust law has long received the most attention in the extraterritoriality field, it represents only one of a number of US statutes that apply the political, social or economic policies of the United States abroad.[1] Acts such as the International Emergency Economic Powers Act[2] and the Export Administration Act of 1979[3] are based on the legal notion that a foreign affiliate or subsidiary may be as equally subject to United States jurisdiction as its US parent. The same principle is employed to endow regulatory agencies such as the Securities Exchange Commission, the Commodities Futures Trading Commission and the Federal Trade Commission with extraterritorial jurisdiction. Thus, given the wide variety of laws and regulatory agencies concerned with activities occurring outside the United States, it is not difficult to see the problems posed to other nations when it is claimed that persons located or carrying on business within them are subject to US jurisdiction as well.

The Principle of Territoriality in International Law

International law recognizes a system of states that are discrete and equal in that while a state may prescribe laws affecting persons situated in or events occurring within another, it cannot exercise a sovereign prerogative or take enforcement action in another state's territory in the absence of consent.[4] Thus, the jurisprudence is replete with statements such as that in the Island of Palmas Case which noted that the "principle of the exclusive competence of the State in regard to its own territory. . .[is the] point of departure in settling most questions that concern international relations."[5] This view underlies the territorial principle, the most widely accepted basis for jurisdiction; it implies exclusivity of jurisdiction and generally does not countenance areas of concurrent jurisdiction where two or more states may attach legal consequences to an act.[6] Due to the complexity of relations between events and persons situated in different states, however, there have been encroachments upon, and modifications to, the principle of strict territoriality. Where extraterritorial jurisdiction has been claimed, state practice has tended to rely on such principles as nationality. However, these modifications to the basic principle of territoriality still tend to recognize the interests of other sovereign states; hence the development of conventional law dealing with extradition, taking evidence abroad and other matters of judicial assistance.

The territorial principle has had a long-standing basis in municipal judicial decisions which, in part, form the basis of international law. More than 100 years ago, in the case of Phillips v. Eyre, the English Court of Appeal dismissed an argument that it possessed jurisdiction over what was alleged to be an unlawful act committed outside the United Kingdom. In so doing the court commented:

> An act might not only be lawful but might even be enjoined by the law of another country, which would be wrongful, and give a right of action by our law, and it certainly would be in the highest degree unjust that an individual who has intended to obey the law binding upon him should be held liable in damages in another country where a different law may prevail.[7]

This approach was embraced by the US Supreme Court in 1909 in its famous decision in the American Banana Co. v. United Fruit Co. case. There the Supreme Court was presented with an allegation that the defendant had conspired with the government of Costa Rica to take control of territory located in the vicinity of the Costa Rican-Panamanian border and thereby had prevented the plaintiff from operating a banana plantation. This, it was alleged, constituted a breach of the Sherman Act.

In order to hear the case, it was necessary that the plaintiff demonstrate that the court possessed jurisdiction over the subject-matter that formed the basis of the complaint--i.e., that the particular case fell into a class of cases that previous courts had adjudicated. In finding against the subject-matter jurisdiction necessary to found the action, Mr. Justice Holmes based his decision on the then well-accepted rule that "the character of the act as lawful or unlawful must be determined wholly by the law of the country where the act is done". According to this rule, the legality of United Fruit Company's action was to be determined by the law of Costa Rica, not the law of the United States. Moreover, this rule did not admit the possibility that Costa Rica and the United States could have concurrent jurisdiction over the activity in question. To Mr. Justice Holmes, the exclusive right to prescribe and enforce a law was an important element of jurisdiction. In his view there were sound reasons for this position:

> For another jurisdiction, if it should happen to lay hold of the actor, to treat him according to its own notions rather than those of the place where he did the acts, not only would be unjust, but would be an interference with the authority of another sovereign, contrary to the comity of nations, which the other state concerned justly might resent.[8]

This reasoning was in keeping with that employed by the courts of other nations at the time. In fact, in coming to his conclusion Justice Holmes relied upon the English Court of Appeal's decision in Phillips v. Eyre. However, American Banana was not destined to remain the law; the US courts would later adopt a more liberal view of jurisdiction.

Changing Views on Territoriality

With interaction between persons situated in different states increasing over time, states have had to confront the problem of attaching legal consequences to activities that commenced in the territory of one state and were completed in another. The principles of subjective territoriality (allowing a jurisdictional claim over a criminal act commencing in the state's territory but consummated abroad) and objective territoriality (allowing jurisdiction over acts commenced abroad but culminating in the forum state's territory) emerged to meet this problem. (The latter is of particular importance to the antitrust field since the laws have been applied to trade restraints entered into abroad which have had an effect on US trade and commerce.) Thus, the notion of concurrent criminal jurisdiction took hold. It should be noted, however, that the principle initially dealt with generally-recognized crimes involving direct physical harm. A person standing in State A firing a bullet into State B and thereby killing someone was said to be subject to the jurisdiction of both states.[9] The principle was later extended to defamation when a

Mexican court permitted the prosecution of a US national for the alleged libel of a Mexican citizen in a US newspaper.[10] It was extended further by the US courts to reach "effects" or "repercussions" of trade-restraining conduct entered into by non-US nationals abroad.[11]

The principle's extension from criminal (malum in se) offences causing direct physical harm to public welfare (malum prohibitum) offences involving purely economic harm is regarded, depending on which side of the border one sits, as either an important step in the development of a jurisprudence suited to dealing with modern-day complexities which defy the old approach of "localizing" facts, events and relationships in order to determine jurisdiction, or as something that is bound to lead to international conflict as states apply potentially contradictory legal rules to the same activity. Those defending the more liberal approach point out that the territorial principle emerged when states were truly discrete entities and interaction between persons situated within different states was sparse and intermittent when compared to the modern world. They argue that to ignore the tremendous growth in transnational interaction between the subjects of national regulation, be they individuals or multinational corporations, is to fail to come to grips with the jurisdictional challenges of a far different world than that which existed when the territorial principle achieved its pre-eminence.[12]

Those who oppose the liberal jurisdictional theories argue that the emphasis placed on transnational activity to justify a departure from the territorial principle goes too far; it undermines sovereignty and offends the principle of non-interference in the affairs of other states by supporting an alleged equality of jurisdictional interests in situations where the state in whose territory the activity occurs still has a much weightier interest than the state asserting extraterritorial jurisdiction.[13]

Both sides can marshall much in support of their positions. Transnational commercial activity has dramatically changed the world and requires a modification of the traditional state-centric view of international relations.[14] At the same time, however, the machinery of the modern state has undoubtedly grown in size and complexity. Centuries ago, states regulated only two areas of public law: excise and criminal law. Now, regulatory control of such things as banking, telecommunications, shipping and transportation is the norm rather than the exception. Thus, what seems to have happened has been an increase in transnational interaction which, itself, would seem to signal the relative decline of the nation-state, but in fact, parallels the growth in the scope and sophistication of the machinery of the modern state and the number of subjects that it seeks to regulate. Increased interaction between the subjects of national regulation has made conflict between the public laws of different states inevitable, particularly when states differ in their jurisdictional claims.

International law does not provide much assistance in delimiting the jurisdiction of states. Modern writers are in general agreement that criminal jurisdiction need not be strictly territorial. However, they differ as to the circumstances in which extraterritorial jurisdiction can be asserted. Jennings argues that state practice suggests that some justifying principle is thought to be necessary to found extraterritorial jurisdiction.[15] Akehurst does not see the need for justification in the absence of a prohibitive rule such as non-interference in the affairs of another state.[16]

Over time, states can and do arrogate for themselves greater claims to jurisdiction than hitherto have been accepted in international law. The possibility exists that, in prescribing laws, individual states will go beyond the generally recognized limits upon their legislative jurisdiction; the gradual expansion of territorial waters from a three-mile to a twelve-mile limit is an example. If such a claim eventually meets with the approval of other nations, a new rule of international law will emerge and what was once an expansive claim to jurisdiction will become the norm. If the claim is opposed by other states, the result is, at a minimum, uncertainty in the law for one state will claim to possess jurisdiction in circumstances where another would not. This state of uncertainty, and indeed discord, is precisely what has happened when antitrust law has been applied to activities occurring outside the United States' territorial bounds. In this case, the expansive claim to jurisdiction has been made by Congress in endowing the Sherman Act with an international orientation, by the US courts in interpreting the Act's reach and by US government enforcement agencies in exercising their prosecutorial discretion.

The US Claim to Jurisdiction

The claim to extraterritorial jurisdiction in antitrust matters is partly attributable to US legal culture, which evidences a puritanical concern that lawbreakers be ferreted out and brought to justice wherever they may be located, and the belief that the emergence of monopoly power is inimical to US political and economic interests. Indeed, the antitrust laws have enjoyed a status that is otherwise usually reserved for the Constitution. In an oft-quoted passage in the decision of United States v. Topco Associates,[17] the US Supreme Court referred to the Sherman Act as the "Magna Carta of free enterprise". Similarly, in its Antitrust Guide for International Operations,[18] the Department of Justice noted that the "antitrust laws are the foundation of our broad national commitment to competition based on efficiency--to providing consumers with goods at the lowest price that efficient business operation can justify, and to allowing enterprises to compete on the basis of their own merit."[19] Such statements are common in antitrust jurisprudence and signal the strength of the legislative policy underlying this law.

The central piece of US antitrust legislation is the Sherman Act which declares to be illegal "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with foreign nations."[20] This section (and section 2, the other substantive provision of the Act) applies expressly to restraints of trade "with foreign nations". This phraseology is derived from the language of the US Constitution which grants to Congress the power to regulate commerce "with foreign Nations and among the several States". The insertion of the phrase "with foreign nations" is significant because it gives the Sherman Act an international orientation; it is expressly concerned with more than simply domestic trade and commerce. The question that arose on numerous occasions is in what way could the Sherman Act be applied to activities occurring outside the United States? Did the phrase "with foreign nations" constitute a grant of jurisdiction to the courts to adjudicate upon commercial dealings within foreign nations?

Although the Supreme Court initially answered that question in the negative, subsequent judicial decisions loosened the strict territorial limitations placed on the Sherman Act by American Banana.[21] It was not until 1945, however, with the judgment of Mr. Justice Learned Hand in the Second Circuit Court of Appeals' decision in United States v. Aluminium Company of America[22] (the Alcoa case), that a coherent doctrine emerged to deal with trade-restraining activity occurring outside the United States. At issue there was an "Alliance" entered into abroad by a number of foreign companies (British, Canadian, French, German and Swiss) whereby a quota system for the production and sale of aluminum was implemented. The agreement was lawful in Switzerland--the jurisdiction in which it was entered into--but it applied to sales to the United States.

Arising at a time of greatly expanded US influence and presence abroad, the case presented an opportunity for the Court of Appeals to reread the intent of the Sherman Act in the light of new international conditions. In order to circumvent Mr. Justice Holmes' rather cogent observation that, in reading the Sherman Act, "words having universal scope such as 'every contract in restraint of trade', 'every person who shall monopolize', etc., will be taken, as a matter of course, to mean everyone subject to such legislation, not all that the legislator subsequently may be able to catch", the Court of Appeals had regard even to the speeches of Senator Sherman himself in the Congressional Record. In pronouncing the right of a US court to determine the legality of the arrangement in question under US law, Mr. Justice Learned Hand stated:

> [I]t is settled law--as "Limited" itself agrees--that any state may impose liabilities even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends; and these liabilities other states will ordinarily recognize. . . . Both agreements would clearly have been unlawful had they been made within the United States; and

> it follows from what we have just said that both were unlawful, though made abroad, if they were intended to affect imports and did affect them.[23]

It is not clear, at least to a foreign observer, that the principle enunciated above was "settled law" when applied to a state's right to regulate trade and commerce. The authorities cited by Learned Hand did not seem to be on point. Notwithstanding that, the decision was embraced willingly in subsequent decisions of the US courts (which actually loosened the jurisdictional test even further) and Learned Hand's "effects" doctrine has provided the legal justification for the extraterritorial application of antitrust law.

It was subjected to criticism, however, by foreign and some US commentators. Professor Jennings argued that the "effects" doctrine went beyond the commonly understood limits on objective territoriality in that economic effects were legally separable from the acts complained of in the US court:

> [I]t may, with respect, be submitted that the Alcoa pattern of case goes too far when 'jurisdiction' is assumed over foreigners' foreign agreements, merely because it has been possible to allege some 'effects' on United States imports or exports, and because the agreement would have been illegal if made in the United States. This kind of jurisdiction seems to offend in two ways. First, since this jurisdiction is rested by the court on the objective test of territorial jurisdiction, it must be kept within the confines of the concept. But to extend that concept to cover effects in the sense of mere repercussions--sometimes repercussions ancillary to the purpose of the scheme as in the Alcoa case--is not only to extend it beyond the limits covered by authority but also to reduce it to an absurdity. . . . Secondly, even allowing a most liberal view of the limits of extraterritorial jurisdiction, these cases are an attempt to export into other countries and to make operate there what are after all peculiarly American political notions.[24]

In his seminal exposition on jurisdiction, F.A. Mann wrote, " 'effect', whether intended or merely forseeable or unexpected, does not constitute a sufficiently close connection with the importing country so as to permit the assumption of legislative jurisdiction by the latter."[25]

Even though the legality of the Alcoa jurisdictional claim was questionable, the US courts eagerly embraced the loosening of the strict territorial limits placed upon the application of the Sherman Act by American Banana some 35 years before. Of the line of cases purporting to follow Alcoa, one important observation should be made. These cases loosened the requirements enunciated by Justice Learned Hand even further in order to find jurisdiction. While he had required the subjective element of "intent" in addition to a direct effect on US trade and commerce, in United States v. Imperial Chemicals[26] the court said the test was satisfied where there was "a conspiracy that affects American commerce". In Timken Roller Bearings Co. v. United States,[27] the jurisdictional finding required only "a direct and influencing effect on trade". Yet subjective intent was an integral part of Learned Hand's test. Thus, while the Alcoa decision gave rise to concern on the part of other states, subsequent judicial decisions applied even looser jurisdictional tests.

So far as other Western states were concerned, therefore, Alcoa and its progeny signalled a departure from the principle of strict territoriality upon which a state's right to regulate trade and commerce traditionally was based. To such states as Canada and the United Kingdom, jurisdiction could be claimed only if an overt act taken in furtherance of a foreign conspiracy in restraint of trade occurred within the state. Alcoa rejected the need for an overt act and held that the conspiracy's effect on US trade and commerce sufficed to allow the court to claim jurisdiction on the basis of the objective territoriality principle.

The Lack of an International Consensus on the Regulation of Competition

The "effects" doctrine was enunciated at the beginning of the most dramatic increase in international economic activity in history. The rapid proliferation of multinational corporations, the rise in cross-border financial transactions, and the general expansion of the world economy in the post-war period have all combined to create interdependence in the economies of states. During this period, states grew more interventionist in their control of resources and commerce.

This occurred both domestically with the establishment of marketing boards and state-owned or -controlled enterprises, and internationally with the creation of producer cartels and intergovernmental commodity agreements. The Sherman Act was originally aimed at private business restraints rather than the kinds of production and marketing arrangements encouraged by modern-day governments.

Notwithstanding the general commitment to trade liberalization evidenced by their participation in GATT, states have shown an increasing tendency to employ government-created restraints on trade. The use of quotas, orderly marketing arrangements, subsidies, export financing and state trading embargoes (such as the Arab boycott of Israel), to name a few mechanisms, has led some observers to conclude that with the decline in private producer cartels in the post-war period, governmental restraints now represent the greatest threat to trade liberalization.[28] Ignoring the obvious divisions between East and West and North and South,[29] notwithstanding West Germany's adoption of a strict antitrust law and the development of EEC competition law, there remain important differences of opinion between the United States and most other Western nations in regard to both content and enforcement of competition law. The Sherman Act expresses US public policy; other than in its most general form, that policy is not commonly shared. With respect to sanctions, the view that restrictive trade practices are a crime or should give rise to such substantial civil penalties as treble damages awards is not universally held. EEC law does not criminalize anti-competitive behavior and its remedies tend to be prospective rather than compensatory and punitive. Similarly, there is a tendency in US antitrust law to focus on the nature of an activity rather than its purpose. Thus, there is a class of offences, of which price-fixing and market-allocation are two which are declared to be per se offences--activities that have such a "pernicious effect on competition and lack of any redeeming virtue" that an "elaborate inquiry as to the precise harm (that they may) have caused or the business excuse for their use" is generally not worthwhile.[30] Most other nations that enforce a competition law are willing to subordinate or at least consider competition in the light of other national interests. It is reasoned by the European Commission, for example, that per se offences ignore other significant social and political interests for the sake of convenience.[31] Finally, so far as procedure is concerned, the United States is the most reliant of all states upon its judicial system for the resolution of antitrust disputes; once again, enforcement in the EEC, for example, is generally administrative rather than judicial.

The absence of a consensus on the substantive content of competition law and its enforcement was noted by the former Acting Director of the Canadian Bureau of Competition, now Mr. Justice Henry:

> [A]ll nations do not agree on the policy and form of antitrust law; for example, Canada is the only nation whose combines laws correspond in broad outline to those of the United States. What is a crime in one country may therefore be merely subject to civil prohibition or regulation, or permitted, or even encouraged, in another. . . . [Moreover] most antitrust laws [including those of the United States] have a certain ambivalence as between the domestic and foreign activities of nationals; for example it is common to allow nationals to enter into collusive arrangements to penetrate and deal in foreign markets--the antitrust laws are concerned with effects in the domestic economy, not in some other economy.[32]

The lack of consensus is evidenced not only by state practice but also by the paucity of international conventional law. At present, two non-binding instruments deal with the question: the 1967 OECD "Guidelines for Multinational Enterprises" and the UNCTAD-sponsored United Nations "Set of Multilaterally Agreed Equitable Principles and Rules for the Control of Restrictive Business Practices" (the "RBP Code", adopted in 1980). It might be argued that the General Assembly's unanimous approval of the intentionally vague standards contained in the latter evidences international agreement on minimum substantive antitrust standards.[33] Nevertheless, it should be noted that the delegates of Australia, Canada and the United Kingdom each took the opportunity to comment that the RBP Code did not justify the assertion of jurisdiction on the basis of the "effects" doctrine because principles of sovereignty and comity prevented such unilateral action.[34]

In the absence of an international consensus as to the role of competition in international trade, the US courts and the government agencies responsible for antitrust enforcement have taken a permissive view of international law, considering themselves less rather than more constrained in claiming jurisdiction over activities occurring outside the United States. In the 1958 edition of his book Antitrust and American Business Abroad, Kingman Brewster observed that since there is no international authority to which the United States has submitted the question of the extraterritorial application of antitrust law, "the decision to restrict jurisdiction is a matter of national policy."[35]

Although many states and commentators would take issue with Brewster's assertion, he identified the problem that confuses this area of international relations. Although international law postulates broad principles of sovereignty and jurisdiction, it does not provide detailed rules for determining the lawful bounds of a state's claim to jurisdiction. As stated in the Reporter's Note in the Restatement of the Law; Second: Foreign Relations Law of the United States "international law has not yet developed to the point of controlling the choice that a particular state may make in most cases between its own law and that of another state also having jurisdiction".[36] The reason is that state practice generally (although not absolutely) adheres to the territorial principle and, in the absence of frequent jurisdictional conflicts, states have not found it necessary to devise rules governing judicial abstention. That, along with frequent diplomatic protests (Davidow notes that by informal estimate there have been five diplomatic protests for every instance of support and three blocking statutes for every co-operation agreement)[37] suggests that actions taken pursuant to the US claim may not always be supportable.

US jurisprudence has resolved the dilemma created by the apparent absence of detailed rules for determining the lawful limits to jurisdiction by providing for an expansive notion of jurisdiction and then devising principles of law that may excuse the conduct complained of, but do not negate the jurisdictional claim. For example, following this approach the US courts would still have jurisdiction over a restrictive business practice occurring in Canada and engaged in by non-US companies even if the Canadian government ordered the companies to participate; but the companies might have a good defence under US law because their acts may have been compelled by Canada. However, the fact of government involvement would not preclude the court from scrutinizing the arrangement. If the defence of compulsion was not met, liability would follow.

This unilateral claim to jurisdiction over activities occurring in another state leads to extremely difficult problems for those persons who transact business over national boundaries. It is there that the potential for legal and diplomatic conflict is created and--from the foreign perspective--it is there that the difficulty in containing conflict is the greatest.

The Potential for Diplomatic Conflict

The possibility of interference in the affairs of another state is increased when the state claiming extraterritorial jurisdiction applies a law that contradicts or conflicts with the law of the place where the impugned activity occurred. Of course, simply because an activity is lawful in one state does not preclude the exercise of criminal jurisdiction by another. A state could permit the forgery of another state's currency in its territory; such an act would be in violation of international law and would entitle the other state to exercise criminal jurisdiction over the forgerer.[38] Similarly, it would be permissable for a state to exercise extraterritorial jurisdiction over activities occurring in a neighbouring state which were aimed at fomenting revolution in it.[39]

Beyond these clear examples where state responsibility is arguably involved, the question remains: what if the conduct is entirely lawful in the state in which it occurred and another state attempts to impugn it? Jennings argues that "extraterritorial jurisdiction may not be exercised in such a way as to contradict the local law of the place where the alleged offence was committed."[40] He agrees that because of the possibility of a state allowing itself to be used as a sanctuary, the principle cannot be an absolute one.

However, "a concurrent jurisdiction which is actually contrary to the local law must trench upon the claim to territorial jurisdiction itself."[41] The point is an important one, for a system of law may be comprised not only by what it prohibits and regulates but also by what it leaves to the liberty of the subject.[42]

Generally, in antitrust matters, US courts have not stayed their hands when faced with such a plea although they have stopped short of applying the law if to do so would be to require acts forbidden by the lex loci.[43] This appears to result from the assumption that jurisdiction to try a case automatically entails jurisdiction to fashion relief when in fact what the court may be doing is exercising an overreaching prescriptive jurisdiction.[44]

It may fairly be said that in providing the doctrinal basis for finding concurrent jurisdiction, the Alcoa decision and its progeny simply ignored the two concerns that constitute the basis of such decisions as American Banana and Phillips v. Eyre: first, that injustice could result from subjecting persons to liability for actions that were entirely lawful in the jurisdiction in which they occurred and, second, the possible infringement of the sovereignty of another state. Alcoa did not consider what ought to follow where the other state possessing jurisdiction either does not agree that there is concurrent jurisdiction (because it refuses to recognize the US claim) or even if it does agree, still opposes the attempt to enforce US law. What result follows where the US courts find concurrent jurisdiction over activity in a state that does not regard such activity to be punishable or perhaps even considers it to be desirable?

For many years, the US courts simply focused on the defendant's position and not on the interests of the other state (or states). Thus, certain defences, notably the "sovereign compulsion"[45] and "Act of State"[46] defences were utilized to resolve the problem that arose when a person was forced to engage in an anticompetitive act by the decree of a foreign state. Leaving aside the strictness of the compulsion defence (it is a very narrow one, requiring clear and unambiguous evidence of governmental compulsion), and the confusion surrounding the Act of State defence (judicial opinion is divided over whether the court can inquire into the motivations behind a foreign act of state), the use of such defences may achieve the limited objective of excluding liability in the United States for conduct required of it by a foreign sovereign. However, it misses the wider problem of judicial encroachment on the foreign state's right to political and economic self-determination.

An attempt was made to rectify the situation in 1975, when the Ninth Circuit Court of Appeals rendered its decision in Timberlane v. Bank of America.[47] At issue was an allegation that the defendants had conspired with other parties in Honduras, including certain government officials, to prevent the plaintiff from establishing a business presence in that country's forestry industry. The district court had concluded that on the facts as alleged, it did not possess subject-matter jurisdiction. On appeal, the Court of Appeals took the opportunity to re-examine the state of the law and concluded that the "effects" test was insufficient as a jurisdictional base. In addition to demonstrating an effect on trade and commerce and showing some "cognizable injury" to the plaintiff, there was the additional consideration "unique to the international setting" of whether the interests of, and the links to, the United States were sufficiently strong "vis-à-vis those of other nations, to justify an assertion of extraterritorial authority". Given the international ramifications of the extraterritorial application of antitrust law, the court concluded that a "jurisdictional rule of reason" should be employed to ascertain the existence of subject matter jurisdiction. In addition to establishing the existence of an effect on US commerce, there were other elements "to be weighed [including]. . .the degree of conflict with foreign law or policy, the nationality or allegiance of the parties and the locations or principal places of business of corporations, the extent to which enforcement by either state could be expected to achieve compliance, the relative significance of effects on the United States as compared with those elsewhere, the extent to which there is explicit purpose to harm or affect American commerce, the foreseeability of such effect, and the relative importance to the violations charged of conduct within the United States as compared with conduct abroad."[48] [illegible] referring to these factors--all of which pointed to the reasonableness of the jurisdictional claim--it was thought that the "effects" test would be augmented in a way that would make the court more sensitive to the international implications of its decision.

The Court of Appeals did not decline jurisdiction on the facts as alleged, but remanded the case to the district court to make the jurisdictional determination in the light of the test enunciated by it. Thus, Timberlane seemed to portend a new era of sensitivity to foreign interests, if not restraint, on the part of the US courts.[49] The decision was hailed by various US commentators as evidence of a more sensitive approach to jurisdiction than the "effects" doctrine.[50]

However, the Timberlane approach has not found acceptance in all quarters. It was held not to be the law of its circuit by the Seventh Circuit Court of Appeals in the uranium cartel litigation.[51] Moreover, while it sounds reasonable in its approach, the fact that it is the court of one state that weighs the interests of two different nations suggests possible difficulties in application.

Notwithstanding the Timberlane decision, it appears that the jurisdictional theories and the various defences are based on recognizing foreign sovereignty only when that sovereignty might be termed "active", meaning that the mere fact that another state possesses jurisdiction over the activity in question does not in any way negate the US claim. The other state must exercise its jurisdiction over the activity through an act of legislation, for example, before the US courts will address the problems that are created by a finding of concurrent jurisdiction. The fact that the foreign state countenances or even encourages the activity is irrelevant to the jurisdictional issue and will not suffice as a defence for the parties who have engaged in the activity.

There is a more technical point that contributes to an understanding of the problems created by the extraterritorial enforcement of antitrust law. Just as the Alcoa decision stands in sharp contrast to the claims of other states as to the extent of their jurisdiction in international law, when it comes to the question of adjudicatory jurisdiction (whether given a particular set of facts a court will hear a case), the US approach is very much one of reconciling competing interests in contrast to the English common law tradition of determining whether there are sufficient "localizing" or "connecting" factors between the claim and the court in which it is sought to be heard. Thus, where in the latter the jurisdictional determination is largely a question of fact, US courts, especially those applying the Timberlane approach, appear to view it as having a flexible character, in that adjudicatory jurisdiction may be claimed in some circumstances and not in others, depending upon the nature of the case. This is more a question of policy than of fact and perhaps derives by analogy from the treatment of jurisdictional questions in US "conflicts of law". According to this reasoning, the taking of jurisdiction may depend upon such factors as the strength of the legislative policy on which the law sought to be enforced is based.

This tendency to view adjudicatory jurisdiction as a discretionary matter is borne out not only by judicial decisions but also in statements of the US Department of Justice. In discussing the "effects" doctrine, the Department's Antitrust Guide for International Operations notes: "[W]hen an unresolved and direct conflict between the laws of two countries imposes substantial hardship upon the affected party, comity may indicate that the laws of the nation with the more important national interests at stake, based upon its own laws and policies, should prevail."[52] The problem with this approach is that since the antitrust laws have enjoyed such a high esteem in the United States--reflecting as they do an extremely strong national policy--it is difficult to conceive of a national policy of a foreign state that would be seen to be of greater weight. This is all the more the case since the question is being decided not by an international tribunal but rather by the domestic courts of one of the two states whose legislative policies are being evaluated. This led Joelson to argue that the guide "loads the dice" in favour of the US national interest.[53] In criticizing the guide's comity analysis, Joelson wrote:

> The. . .discussion of comity. . .suggests that it may be invoked to justify nonenforcement of U.S. antitrust law only when the challenged activity has little or no impact on

> the commerce of the United States. But there is little need for comity in its true sense in that situation. The more important situation, and the true test of comity, is where both national interests are strong and are clearly involved, with the private parties caught in the middle of two inconsistent demands. The Guide, in that situation, clearly gives the nod to the U.S. interest rather than to international conciliation.[54]

Unfortunately, from the foreign perspective, comity problems seem to arise only when there is some positive act or expression by the other state. A diplomatic note sent after the fact protesting the jurisdictional claim seems to be of little weight if the foreign government merely asserts its view that since the conduct complained of was lawful in its territory it ought not to be subjected to scrutiny in the US courts. There is no body of case law in the United States that recognizes the right of another state not to legislate with respect to the specific activity and yet still shield it from antitrust exposure. This is one of the areas of disagreement between the United States and those states which oppose it in these matters. The latter are of the view that it is as much an exercise of sovereignty to permit restraints in trade as it is to compel or enjoin them, because inherent in the concept of sovereignty is the state's right not to prohibit certain activity occurring within its territory. As Lowe has commented, "The supposition that the sovereignty of foreign states demands respect only when it is exercised by the promulgation of laws regulating the matter in question is patently inappropriate where the foreign state consciously implements a laissez- faire policy".[55] Similarly, in criticizing a US district court decision which found certain practices engaged in by Swiss watchmakers to be violations of the Sherman Act, Mann noted:

> One of the most remarkable legal aspects of the judgment is the suggestion that 'if, of course, the defendants' activities had been required by Swiss law this court could indeed do nothing.' In other words, the court's powers derived from the fact that 'the defendants' activities were not required by the laws of Switzerland', but merely permitted by them. It is impossible to understand the basis of this distinction. If Swiss law is relevant at all, then surely, all that matters is that by Swiss law the impugned arrangements were lawful.[56]

The US courts have refused to recognize this position. In Continental Ore Co. v. Union Carbide and Carbon Co.,[57] notwithstanding the fact that due to wartime exigencies the government of Canada had delegated a discretionary authority to Electro Met of Canada to purchase and allocate to Canadian industries all vanadium products, the company's decision not to purchase vanadium from the plaintiff from the Canadian market was not shielded from antitrust liability. Both the trial court and the court of appeals had concluded that Continental could not recover from the defendants for the injury to its Canadian business. However, the US Supreme Court found that conclusion to be in error. Electro Met was not acting as an arm of the government of Canada in this regard. Mr. Justice White wrote:

> Respondents are offered no defense from the fact that Electro Met of Canada in carrying out the bare act of purchasing vanadium from respondents rather than Continental, was acting in a manner permitted by Canadian law. There is nothing to indicate that such law in any way compelled discriminatory purchasing, and it is well settled that acts which are in themselves legal lose that character when they become constituent elements of an unlawful scheme.[58]

Thus, in keeping with this decision, rather than recognize a grant of discretionary power, which is as much of an exercise of government power as a binding order, the US courts look for a positive act compelling the alleged violation of the Sherman Act before antitrust liability will be shielded.

Finally, it should be recognized that the US courts have placed themselves in a position where, even if a retreat from the expansive claim to jurisdiction was desired, it could likely be achieved only through legislative means. It has been observed that although international law postulates broad principles of jurisdiction, it does not provide detailed rules for determining the bounds of a state's exercise of jurisdiction. Moreover, notwithstanding that international law enjoys primacy over national law, it does not prescribe or govern the content of such law. Thus, national conduct may be entirely valid under domestic law even though it constitutes a breach of public international law. The Sherman Act expressly applies to trade and commerce "with foreign nations" and previous US judicial decisions have given a particular meaning to that phrase. Although the United States may be acting in excess of jurisdiction in international law, as a matter of domestic law, it may hardly be open to a US court to ignore the jurisprudence and find that it has no jurisdiction in a situation where numerous previous US courts have come to the opposite conclusion.[59]

Hitherto, this article has focused on the jurisprudential problems raised in extraterritorial antitrust enforcement. Two more problems of a practical nature remain to be identified although they cannot be given more than cursory treatment. The first lies in the different treatment that foreign governments and companies are likely to receive at the hands of the US Department of Justice as compared to private litigants. Despite some rather spectacular excesses (as, for example, where the Justice Department named former Saskatchewan Premier Ross Thatcher as an unindicated co-conspirator in the potash case),[60] foreign interests generally have been taken into account in recent US government investigations. Obviously, the US Executive is experienced in diplomatic consultation and it is not unusual for the Justice Department to consult with foreign officials prior to making a prosecutorial decision.

In private treble damages litigation, however, recent cases demonstrate that foreign interests are not adequately taken into consideration. There are a number of practical reasons for this. First, private litigants are ill-equipped and certainly plaintiffs are disinclined to alert the court to the international ramifications of the proceedings. In fact, it may actually be in the plaintiff's interests to attempt to exacerbate relations with the other interested states. Second, judges are not attuned to sensitive diplomatic concerns (assuming that such concerns are regarded to be legally relevant) nor are courtrooms necessarily the fora in which governments are prepared to make public the kinds of communications that would normally flow through diplomatic channels. Third, when foreign governments have made amicus curiae interventions (which in themselves can be construed as implicitly acknowledging the right of US courts to claim jurisdiction) and have retained US counsel to act on their behalf, their statements have been attacked by opposing counsel as unauthoritative because they are "briefs written by American lawyers."[61] Indeed, in the recent uranium cartel litigation the Seventh Circuit Court of Appeals completely misunderstood the basis of foreign government interventions. The governments of Australia, Canada, South Africa and the United Kingdom intervened to argue that the court ought not to exercise jurisdiction. They had done so on the urging of the Department of State which had refused to take a position on the matter. In their decision, the appellate judges expressed "shock" at the fact the governments had "subserviently" presented the case on behalf of certain defendants who had declined to submit to the court's jurisdiction.[62]

The outrage of the four governments--who, after all, were acting on the State Department's advice--led both the State and Justice Departments to write extraordinary letters to the Court of Appeals explaining that, for "reasons that may not have been apparent to the Court", its remarks had "caused serious embarrassment to the United States in its relations with some of our closest allies".[63] If proof was needed to demonstrate the soundness of the Act of State doctrine and the desirability of judicial restraint in matters involving foreign relations, the Court of Appeals' conduct would suffice.

While recent developments such as Timberlane suggest that foreign interests should be considered in a comity analysis, the fact remains that district court judges are not equipped to make such a determination. It is too much to ask a judge sworn to apply the laws of his own country, to evaluate objectively the underlying interests of two conflicting public laws or policies where one is central to his society and the other is foreign to it. Yet that is the task that US courts have set for themselves--in one instance, for example, weighing the policies behind US antitrust enforcement against those underlying German banking secrecy laws[64] and, in another, weighing antitrust policy against a foreign nation's control of natural resources.[65] The fundamental problem in attempting to transplant the comity analysis from the United States to the international arena is that, in US state law, there is a general uniformity in legal policy that is conspicuously absent at the international level. In a domestic conflicts of law situation, the state court enjoys some confidence that even if it refuses jurisdiction the case will be resolved according to due process and by application of generally similar law. No such confidence can be held in the international situation. To decline jurisdiction may well bring an end to legal proceedings because foreign law may not even recognize a cause of action.[66]

Lest it be thought that these kinds of criticisms of the comity analysis are made only by foreign observers, it is instructive to refer to the words of former US Solicitor General and leading antitrust theorist, now a member of the United States Court of Appeals for the District of Columbia Circuit, Mr. Justice Robert Bork:

> Even if a court could accurately assess what is at stake in economic efficiency and foreign relations, the two values are, across broad ranges, incommensurable. How much wealth loss to domestic consumers outweighs how much friction in US relationships with a particular foreign nation? Does it matter whether that nation is powerful or weak, an ally or an adversary or wavering? These are questions that no private party can address knowledgeably and no government can address candidly. So long as our antitrust laws are applied to conduct abroad in which foreign governments have been involved, district courts somehow must cope with these questions.
>
> It should be obvious that the task cannot be done well. Perhaps it is the hopelessness of the task that leads some judges effectively to ignore the foreign policy problem and to press on with discovery orders, followed by sanctions when the defendants cannot produce documents and witnesses because of foreign blocking laws.[67]

Similarly, the former Assistant Attorney General, Antitrust Division, William F. Baxter, commented that the comity doctrine "has been characterized by far too much vagueness and too much discretionary freedom to facilitate the necessary business and investment planning."[68] Arguing that the problem of international antitrust enforcement involves a clash of fundamental national interests, Baxter suggests that such clashes are "unlikely. . .to be resolved satisfactorily in courts."[69] Yet, with the State Department increasingly avoiding intervention in domestic civil suits and the resulting lack of an authoritative expression of the views of the Executive, a district court is thrust into a political and managerial role generally eschewed by the judiciary[70] and is called upon to render decisions that may have significant diplomatic ramifications.

The second practical problem in international antitrust cases lies in the fact that the discovery (or fact-finding) process almost inevitably leads to conflict. Again, US law differs from that of its allies in allowing broad discovery not only of parties to a suit but also of third parties. When information has been sought in a foreign country for the purposes of pre-trial discovery in the United States, foreign governments have tended to restrict its disclosure as a means of combating what is viewed as an expansive claim to jurisdiction. In addition, if the impugned arrangement has had some government involvement, governments have tried to prevent the disclosure of sensitive communications.

The practical effect of this is that it allows the plaintiff to argue that it has not received the full discovery to which it is entitled at law. It is able to argue that the foreign government's actions are motivated not by any concern for legal principle but rather to protect its fellow conspirators. With a wide range of punitive measures available to the court--including the striking of defences, the employment of presumptions and the imposition of a default judgment--the defendant finds itself in the invidious position of being subject to the conflicting demands of two sovereigns: one ordering it to disclose information that the other has forbidden be disclosed. Thus, the multinational corporation becomes the focal point of the jurisdictional dispute.

Problems for Canada

It appears that Canada is exposed to the extraterritorial application of US antitrust law more than any other nation in the Western world. This is due not only to the high level of US investment in the resource and industrial sectors (see Table 1) but also to the large volume of trade between the two countries.

By employing a voting control test (whereby Canadian subsidiaries and affiliates may be subject to US jurisdiction if they are controlled by US shareholders), personal jurisdiction over a large number of Canadian-based companies may exist. For Canadian-owned companies and those with minimal US shareholding, personal jurisdiction can be established by employing an easily- satisfied test of whether they are "doing business" in the United States. Even an isolated business meeting may suffice as the necessary territorial connection to find personal jurisdiction.[71] Thus, from the perspective of the US courts a large majority of companies situated in Canada would be considered present in the United States for the purposes of legal proceedings.

The ease of establishing personal jurisdiction combined with the application of the "effects" doctrine to establish subject-matter jurisdiction presents obvious difficulties to a country like Canada whose economy has heavy US investment. The problem is not new. In the late 1950s after the US Department of Justice commenced civil proceedings in the Canadian Radio Patents[72] case, Justice Minister Fulton met with US Attorney General Rogers in an attempt to reduce tensions arising from the case. Fulton emphasized that diplomatic consultation rather than litigation was the appropriate means of resolving international antitrust disputes. As he later reported to the House of Commons:

> In particular, I emphasized our view that to follow any other course could only be based on the unacceptable proposition that foreign subsidiaries of United States parent corporations are merely projections of United States trade and commerce and subject to United States policy in priority to the laws and commercial interests of the country in which such subsidiaries are incorporated or carry on business.[73]

With respect to the implementation of government commercial policy, potential antitrust exposure remains an important concern for any Canadian company that has links to the United States. Given the narrowness of the sovereign compulsion and Act of State defences, companies will be unwilling to co-operate with government in any market-stabilizing or trade-restraining scheme unless protection is afforded through the enactment of legislation (and even then immunity from liability is not assured). In addition, the Canadian government may be obliged to take steps to prevent the disclosure of information to US authorities. The point is made by J.S. Stanford, former Director General, Bureau of Commercial and Commodity Relations, Department of External Affairs:

> [I]f the Canadian Government transmits or permits the transmission of information from Canada to the United States to assist the prosecution of persons or corporations for acts done outside the United States at the request or encouragement of the Canadian Government, then the next time Canada seeks similar cooperation from the private sector of the Canadian economy in the implementation of national economic policy, it must expect the multinationals in Canada first to seek the advice of their US legal counsel, and then to comply with the Canadian request only if compliance will not expose them or their US affiliates to legal proceedings in the United States. . . .The private sector would thus become more responsive to US law than to Canadian law and policy in determining whether and to what extent it would act in the Canadian interest.[74]

This situation, argues Stanford, encourages the Canadian government to become more rather than less interventionist.[75]

Hitherto, this article has focused upon the divergence of the US approach to jurisdiction from that generally taken by other states. There is an additional concern held by foreign governments, namely, the apparently selective commitment to competition evidenced by the United States. The problem of extraterritoriality is exacerbated by the fact that the exigencies of the international trading system, where comparative advantage is often made rather than born, have obliged the United States government itself to engage in anti-competitive practices. A few examples will suffice. For a nation that espouses the belief that competition ensures the most efficient use of goods and the lowest prices to consumers, the US Executive's negotiations and exchange of letters with the government of Japan leading to "Voluntary Export Restraints" on Japanese automobiles appears inconsistent.[76] Similarly, the imposition of an embargo on uranium imports into the United States--an act that Senator Howard Metzenbaum of the Senate Judiciary Committee later acknowledged was "anti-competitive"[77]--resulted from domestic protectionist pressure. Yet that anti-competitive act was not seen as legally relevant when Westinghouse Electric Corporation launched its $6 billion antitrust suit against 29 domestic and foreign uranium producers for alleged violations of the antitrust laws.

The "Escape Clause" of the Trade Act of 1974 allows the President to establish quotas or Orderly Marketing Arrangements where there has been a substantial cause of injury to a domestic industry by foreign competition; there is no need to show unfair competition or predatory action before the clause can be invoked. Section 22 of the Agricultural Adjustment Act of 1933[78] allows the President to impose global quantitative restrictions and duties where imports may interfere with a Department of Agriculture price support program. Finally, the United States demonstrates an ambivalence in prosecuting arrangements affecting US trade and commerce yet authorizing export cartels having no domestic effect under the Webb-Pomerene Act and the Export Trading Company Act of 1982.[79]

The point is that the United States has proven itself willing to sacrifice its avowed commitment to competition if other more important political, social or economic reasons so dictate.[80] Thus a major criticism of the policy of US antitrust enforcement is that, notwithstanding that the United States will take anti-competitive steps when it sees its interests threatened, government agencies and private litigants are given access to the courts to challenge, under US law, the legality of anti-competitive steps taken by foreign governments or, more likely, companies acting pursuant to their directives.

Conclusion

The extraterritorial application of antitrust and other regulatory legislation by the United States has met with increasing foreign resistance in recent years. With the massive Westinghouse case threatening the existence of whole companies and the imposition of the largest fine ever ($6.1 million) in a Justice Department criminal settlement in the North Atlantic Shipping case (which in turn spurred

Federal Maritime Commission and private treble damages actions by approximately 30 private interests),[81] retaliatory steps have been taken by other states. The United Kingdom enacted the Protection of Trading Interests Act, 1980[82] to strengthen measures to prohibit the disclosure of information to US antitrust investigations and to deter private treble damages claims. A novel feature of the Act gives a cause of action to a qualifying defendant who has had treble damages awarded against it, to sue in the English courts to recover the punitive or non-compensatory two-thirds of the award. This "claw-back" provision was viewed with such concern by the United States that it took the unusual step of sending a diplomatic note to the Foreign Office with a request that the note be tabled in Parliament.[83] Nevertheless the bill was enacted into law and since then has been employed on at least three occasions. First, on 3 March 1981, the Secretary of State for Trade directed a London coffee trader not to respond to a request for documents issued by the US Commodities Futures Trading Commission.[84] Then, it was used to enforce compliance with contractual commitments to supply equipment to the Yamal gas pipeline in the face of contrary legal directives made under the US Export Administration Act. Most recently, it has been employed to enjoin a British airline company from proceeding against two British defendants in an antitrust case brought in the US courts. While not yet embracing the "claw-back" device, New Zealand and France have also enacted legislation designed to combat discovery demands made in aid of US antitrust proceedings. Australia recently followed the British lead in enacting a "recovery-back" statute and, more recently, Canada again tabled similar legislation in Parliament.

These retaliatory responses are probably necessary to demonstrate to the United States the gravity of actions taken pursuant to its jurisdictional claim. Indeed, it appears that the Australian legislative response to the uranium cartel antitrust litigation enabled it to extract certain concessions--notably assurances of confidential treatment of information--from the United States in the Australian-United States Agreement on Cooperation in Antitrust Matters concluded on 29 June 1982.[85] However, legislative retaliation is not a lasting solution. What is called for is a variety of initiatives to rationalize the role of antitrust enforcement in the panoply of US trade laws, to reach a consensus on competition in international economic affairs and, most importantly, because it will remain the most significant problem in this and other areas in the future, to devise detailed rules of law concerning the jurisdictional reach of states in an increasingly interdependent world.

Notes

1. See Andreas F. Lowenfeld and Thomas Ehrlick, International Economic Law, (New York: M. Bender, 1975).
2. 50 U.S.C. 1701-1706 (Supp. 1, 1977).
3. Pub. L. No. 96-72, 93 Stat. 503.
4. See M. Akehurst, "Jurisdiction in International Law" (1972-73), 46 Brit. Y.B. Int'l L. 145, at 146-51.
5. Island of Palmas Case, (Netherlands and United States, 1928), 2 R. International Arb. Awards 829, at 838.
6. See R.Y. Jennings, "Extraterritorial Jurisdiction and the United States Antitrust Laws" (1957), 23 Brit Y.B. Int'l L. 146.
7. Phillips v. Eyre, (1869), L.R. 4 Q.B. 225; aff'd. (1870), L.R. 6 Q.B. 1.
8. American Banana Co. v. United Fruit Co., 213 U.S. 347 (1909).
9. See the Report of the Rapporteur, Dr. A.J. Riedweg, "The Extra-Territorial Application of Restrictive Trade Legislation: Jurisdiction and International Law" in the Report of the Fifty-first Conference of the International Law Association (ILA), held at Tokyo (1964), 357. "The Harvard Draft Convention on Jurisdiction With Respect to Crime" (1935), 29 A.J.I.L. Supp. 435, at 480 provides in article 3:

   > A State has jurisdiction with respect to any crime committed in whole or in part within its territory. This jurisdiction extends to
   >
   > (a) Any participant outside its territory in a crime committed in whole or in part within its territory;
   >
   > (b) Any attempt outside its territory to commit a

crime in whole or in part within its territory.

10. Cutting's Case. See Moore, A Digest of International Law ii, 228-42 (1906). In instructing the US Chargé in Mexico, the Secretary of State declared, "To say. . .that the penal laws of a country can bind the foreigners and regulate their conduct, either in their own or in any other foreign country, is to assert a jurisdiction over such countries and to impair their independence. . . . There being no principle of international law which justifies such a pretension, any assertion of it must rest, as an exception to the rule, either upon the general concurrence of nations or upon express conventions". US Department of State, "Report on Extra-territorial Crime and the Cutting Case" (1887) U.S. For. Rel. 751.

11. United States v. Aluminum Co. of America 148 F. 2d. 416 (2d Cir. 1945).

12. See, for example, the comments of Professor Myres McDougal to the ILA's Committee on the Extra-Territorial Application of Restrictive Trade Legislation, in Report of the Fifty-first Conference of the International Law Association (ILA), 330. See also John H. Shenefield, "The Perspective of the U.S. Department of Justice" in Perspectives on the Extraterritorial Application of U.S. Antitrust and Other Laws, edited by Joseph P. Griffin, (Chicago: Section of International Law, American Bar Association, 1979), 13-14.

13. See F.A. Mann, "The Doctrine of Jurisdiction in International Law" (1964), 1 Recueil des Cours, at 95; See also Jennings, "Extraterritorial Jurisdiction", 150-1.

14. Noteworthy in this respect is the pioneering work of Robert O. Keohane and Joseph S. Nye, "Transgovernmental Relations and International Organization" in World Politics (1974) and also Transnational Relations in World Politics (Cambridge, Mass.: Harvard University Press, 1972). See as well, by the same authors, "Introduction: The Complex Politics of Canadian-American Interdependence" (1974), 28 Int'l Org. 595.

15. Jennings, "Extraterritorial Jurisdiction", 150.

16. Akehurst, "Jurisdiction in International Law", 167.
17. *United States v. Topco Associates*, 405 U.S. 596 (1972).
18. US Department of Justice, Antitrust Division, *Antitrust Guide for International Operations*, (Washington: The Division, 1977).
19. *Ibid.*, p. 2.
20. 15 U.S.C. 1. The *Sherman Act* contains basic prohibitions against combinations in restraint of trade and acts of monopolization. The Wilson *Tariff Act*, 15 U.S.C. S8-11 (1976), makes unlawful restraints in trade dealing with the importation of articles from abroad. The *Clayton Act*, 15 U.S.C. S14 (1976), contains a variety of antitrust provisions related to "tying" and exclusive dealing arrangements and mergers. The *Robinson-Patman Act*, 15 U.S.C. S13 (1976), prohibits certain discriminatory practices by sellers. Finally, the *Federal Trade Commission Act*, 15 U.S.C. S45(a)(1)(1976), applies to unfair competition "in or affecting" US commerce.

    The cumulative effect of these statutes is that it is not only cartels that are subject to antitrust scrutiny; sales agreements, distribution agreements, mergers, joint ventures, patent licences, and know-how and trademark agreements all face potential antitrust problems. See Mark R. Joelson, "Challenges to United States Foreign Trade and Investment: Antitrust Law Perspectives" (1980), 14 *Int'l Lawyer* 103, at 105-7.
21. *United States v. American Tobacco Co.* 221 U.S. 106; *United States v. Sisal Sales Corp.* 274 U.S. 268.
22. *United States v. Aluminum Co. of America* 148 F. 2d. 416 (2d. Cir. 1945).
23. *Ibid.*, p. 443.
24. Jennings, "Extraterritorial Jurisdiction", 175.
25. Mann, "Doctrine of Jurisdiction", 104.
26. *United States v. Imp. Chemical Ind.*, 105 F. Supp. 215 (S.D.N.Y. 1952).
27. *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951).
28. See, for example, James A. Rahl, "International Cartels and Their Regulation", in *Competition in International Business*,

edited by Oscar Schachter and Robert Hellawell, pp. 240-276 (New York: Columbia University Press, 1981) at 242.

29. *Ibid.*, p. 271 notes that over 100 nations have no competition law; 21 of the 24 OECD nations and about a dozen developing nations have some kind of competition law.

30. *Northern P. Py. v. United States*, 356 U.S. 1, at 5 (1958).

31. B. Hawk, *United States, Common Market, and International Antitrust: A Comparative Guide*, (New York: Law and Business, 1979), 423-4.

32. D.H.W. Henry, "The United States Antitrust Laws: A Canadian Viewpoint" (1970), *Can. Y.B. Int'l L.* 249, at 282.

33. Joseph P. Griffin, "Possible Resolutions of International Disputes Over Enforcement of U.S. Antitrust Laws" (1982), 18 No. 2 *Stan. J. Int'l. L.* 279, at 282.

34. UN doc. A/35/PV.84, at 8-10, 18-20, 33 (1980).

35. Kingman Brewster, *Antitrust and American Business Abroad* (New York: McGraw-Hill, 1958), 287.

36. American Law Institute, *Restatement of the Law; Second: Foreign Relations Law of the United States*, (St. Paul Minn.: American Law Institute Publ., 1965), "Comment to s. 37", p. 107.

37. J. Davidow, "Extraterritorial Antitrust and the Concept of Comity" 15 *J.W.T.L.* 500, at 502.

38. *United States v. Arjonà*, 120 U.S. 479 (1887).

39. Sir Hersch Lauterpacht, *A.J.I.L.* (1926).

40. Jennings, "Extraterritorial Jurisdiction", 151.

41. *Ibid.*

42. Jennings notes: "the ethos of a system of law is to be collected as much from what it leaves to individual freedom and discretion as from what it requires, forbids or guarantees". See also A.V. Lowe, "Blocking Extraterritorial Jurisdiction: The British Protection of Trading Interests Act, 1980" (1981), 75 *A.J.I.L.* 257.

43. See, for example, the final decree in *United States v. Imp. Chemical Ind.* 105 F. Supp. 215 (S.D.N.Y. 1952).

44. Akehurst, "Jurisdiction in International Law", 195-212.

45. Under the sovereign compulsion defence, the defendant is excused from liability simply because there was no choice but to engage in anti-competitive behaviour, being compelled to do so by the foreign sovereign. The defence has succeeded in only one reported case, namely, Interamerican Refining Corp. v. Texas Maracaibo, Inc. 307 F. Supp. 1291 (1970).

46. The defence of "Act of State" derives from the judiciary's recognition that the courts should exercise restraint in cases involving matters of relations between nations. Stated as a general principle, the doctrine precludes an inquiry into the validity of acts taken by foreign sovereigns within their own territory. See B. Hawk, "Act of State Doctrine, Noerr-Pennington Abroad and Foreign Government Compulsion Defence" (1978), 47 Antitrust L.J. 987.

47. Timberlane Lumber Co. v. Bank of America, 549 F. 2d. 597 (9th Circ. 1976).

48. Ibid., p. 614.

49. On remand, the district court eventually dismissed the plaintiff's claim employing the balancing test set out by the Court of Appeals. See Int'l Bus. Lawyer, May 1984, p. 199.

The Court of Appeals, Third Circuit, found itself in substantial agreement with the Timberlane approach when it confronted the jurisdictional problem in Mannington Mills Inc. v. Congoleum Corp. 595 F. 2d. 1278 (1979). Having concluded that on the basis of the "effects" doctrine jurisdiction existed, it then turned to examine what it regarded to be the factors relevant to deciding whether jurisdiction ought to be exercised. These included:

- Degree of conflict with foreign law or policy;
- Nationality of the parties;
- Relative importance of the alleged violation of conduct here compared to that abroad;
- Availability of a remedy abroad and the pendency of litigation there;
- Existence of intent to harm or affect American commerce

and its foreseeability;

- Possible effect upon foreign relations if the court exercised jurisdiction and granted relief;
- If relief was granted whether a party would be placed in the position of being forced to perform an act illegal in either country or be under conflicting requirements by both countries;
- Whether the court could make its order effective;
- Whether an order for relief would be acceptable in the United States if made by the foreign nation under similar circumstances;
- Whether a treaty with the affected nation(s) addressed the issue.

50. See, for example, the US Justice Department's Antitrust Guide, p. 7 and Remarks by John Shenefield, Assistant Attorney General, Antitrust Division, 9 August 1978, New York.

51. Westinghouse Electric Corp. v. Rio Algom Ltd. et al, No. 76c 3830 (N.D. Ill., filed Oct. 15, 1976). See 1980-1 T.C. 63, 183 at 77,897.

52. US Dept. of Justice, Antitrust Guide, 52. The notion of comity is something of relatively recent vintage in jurisdictional analysis. It appears once again, however, that different meanings have been attributed to the term. Comity as employed in American conflicts law connotes that in engaging in an "interest analysis" the courts of one American state are obliged to act reasonably and give due weight to the interests of another. Comity in the international legal sense carried with it no sense of legal obligation. Rather, as Lassa Francis Oppenheim notes in International Law: A Treatise, Volume I: Peace, comity is merely a special kind of factor in relations between nation-states: "In their intercourse with one another States observe not only legally binding rules and such rules have the character of usages, but also rules of politeness, convenience, and goodwill. Such rules of international conduct are not rules of law, but of Comity." (London: Longmans Green,

1955), p. 34. Similarly, Ian Brownlie calls it "a species of accommodation. . .(in which) neighbourliness, mutual respect, and the friendly waiver of technicalities are involved." Principles of Public International Law, (Oxford: Clarendon Press, 1973) Second Edition. p. 30.

53. Mark R. Joelson, "An American Practitioner's View" in Perspectives on the Extraterritorial Application of U.S. Antitrust and Other Laws, edited by Griffin, p. 133.

54. Ibid.

55. Lowe, "Blocking Extraterritorial Jurisdiction", 265.

56. Mann, "Doctrine of Jurisdiction", 107.

57. Continental Ore Co. v. Union Carbide & Carbon Co., 370 U.S. 690 (1962).

58. Ibid., at 706-7.

59. Indeed, in Mannington Mills, when the majority of the court introduced new factors into the jurisdictional test in an attempt to apply a reasonableness standard, Judge Adams dissented in part for this very reason stating, "I do not agree that a court may conclude that it is invested with subject-matter jurisdiction under the Sherman Act but may nonetheless abstain from exercising such jurisdiction in deference to considerations of international comity." In his view the comity analysis, if applicable, should be employed to determine the existence of jurisdiction or, if necessary, in devising the court's order at the conclusion of litigation, but it could not be employed as a reason for retreat from a finding of subject-matter jurisdiction.

60. United States v. Amax Inc. et al, 402 F. Supp. 956 (1975).

61. This was a favoured technique in the Westinghouse uranium cartel litigation.

62. Refer to note 51, at 77,897.

63. Letter of 17 March 1980 from Legal Adviser of the Department of State, Robert B. Owen, to Associate Attorney General John Shenefield; Letter of 18 March 1982 from John Shenefield to the Clerk of the Seventh Circuit Court of Appeals.

64. United States v. First National City Bank, 396 F. 2d. 897 (2d

Circ. 1968).

65. In *re Westinghouse Electric Corporation Uranium Contracts Litigation*, 563 F. 2d. 992 (1977).
66. Indeed, the possibility of the absence of any legal remedy outside of the United States is demonstrated in the *Laker Airways* antitrust litigation recently before the courts of both the United States and the United Kingdom. The English Court of Appeal enjoined Laker from prosecuting a civil antitrust complaint as against two British defendants on the strength of an order by the Secretary of State pursuant to the *Protection of Trading Interests Act, 1980*. As the Court noted in the course of its decision, the granting of such relief to the two defendants would be "the first occasion upon which an English court has exercised its jurisdiction to prevent the further prosecution of proceedings before a foreign court or tribunal when there is no alternative forum in England or elsewhere to which. . . Laker can have resort." (Transcript of the Court's decision rendered orally, at 38-39).
67. Robert H. Bork, "Introduction" (1982), 18 *Stan. J. Int'l L.* 241, at 243. (Introduction to a collection of articles on international antitrust enforcement.)
68. William F. Baxter, "Antitrust in the International Arena" (1981), 50 *Antitrust L.J.* at 549.
69. *Ibid.*
70. Baxter, "Antitrust in the International Arena", 543.
71. US Dept. of Justice, *Antitrust Guide*, 8. See also *Cofinco Inc. v. Angola Coffee Co., A.C.*, 1975-2 T.C. 60,456. Personal jurisdiction describes the power of a court to subject parties in a particular case to decisions and rulings made in such a case. It is distinguished from subject-matter jurisdiction, which describes the court's claim to jurisdiction over the class of cases to which a particular case belongs.
72. *United States v. General Electric Co. et al*, (1962) T.C. 70, 342.
73. House of Commons Debates, 1959, Vol. 1, 618.
74. J.S. Stanford, "The Application of the Sherman Act to Conduct

Outside the United States: A View from Abroad" 11 Cornell Int'l L.J. 195, at 205-6.

75. Ibid.

76. An interesting example of the conflict between antitrust philosophy and the harsh realities of international trade is the case of Consumers Union v. Rogers, 352 F. Supp. 1319 (1973). There, a consumers group attacked a steel import quota program in which foreign steel producers voluntarily limited sales and imports into the United States after negotiations in which the Secretary of State and the President had participated. With the matter brewing in the courts, Congress resolved the issue by enacting S.607 of the Trade Act of 1974, 79 U.S.C. S2485 (1976), which precluded antitrust liability for participation in an arrangement whereby imports were voluntarily limited where such an arrangement was undertaken at the request of the Secretary of State.

    Section 203 of the Trade Act of 1974, 19 U.S.C. S. 2253(a), now empowers the President to negotiate those restraints on competition euphemistically referred to as "Orderly Marketing Arrangements".

77. Hearings Before the Committee on the Judiciary, US Senate, 96th Congress, 7 December 1979, p. 50.

78. U.S.C. S.624.

79. 15 U.S.C. S.62-65. The Export Trading Company Act of 1982, Pub L. N. 97-290, has broadened the Webb-Pomerene antitrust exemption for certified export trading companies.

80. There are, of course, many other examples of public restraints on trade implemented by the United States. The most noteworthy are: the numerous textile agreements made with "low cost" exporters of textiles and clothing pursuant to the GATT Multifibre Arrangement; the steel VERs concluded with EEC and Japan; and the periodic restraints on beef exports from Australia, Canada and New Zealand. This is not to suggest that the United States is a worse offender than other states when it comes to protectionism. Rather, it merely demonstrates the

inconsistency between antitrust policy and other US trade laws.

It is noteworthy in this respect that there is a growing body of scholarly literature in the United States calling for a reconciliation of policies underlying antitrust and other trade laws. See, for example, an excellent article by Barry E. Hawk, "International Antitrust Policy and the 1982 Acts: The Continuing Need for Reassessment" (1982), 51 Fordham L.R. 201. See also Jon Paugh, "Antitrust Principles and US Trade Laws: A Review of Current Areas of Conflict" (1980), 12 L. and Pol. in Int'l Bus. 545.

81. Lowe, "Blocking Extraterritorial Jurisdiction", 272.

82. 1980, c. 22: in force 20 March 1980.

83. Lowe, "Blocking Extraterritorial Jurisdiction", 278.

84. Andreas Lowenfeld, "Sovereignty, Jurisdiction and Reasonableness: A Reply to A.V. Lowe" (1981), 75 A.J.I.L. 629, at 638.

85. "The Australian-United States Agreement on Cooperation in Antitrust Matters" is reprinted in part in (1982), 76 A.J.I.L. 866.

Table 1: Foreign-Controlled Investment in Canada, by Sector (Based on Asset Values to end of 1979)

Sector	% of Industry Foreign Controlled	% of Industry US Controlled
Mining	38.3	30.1
Oil and Gas*	62.7	47.4
Total Manufacturing	45.6	34.1
Rubber Industry	90.4	68.6
Transportation Equipment	73.4	68.4
Chemicals Industry	76.5	59.4
Electrical Equipment	60.0	47.5
Heavy Machinery	55.4	46.7
Textiles	55.6	43.9
Metal Fabricating	36.5	29.2
Pulp and Paper	38.6	30.5

Source: Canadian Department of External Affairs, Domestic Information Programs Division, Canadian Foreign Policy Texts 83/1, "Relations Between Canada and the USA." (Ottawa, January 1983), pp. 3-4.

Note

* Based on revenues instead of asset value, foreign control of the oil and gas sector was 79.5 per cent in 1979, and US control was 64.1 per cent.

5: THE INTERSECTION OF CONSUMER PROTECTION LAW AND INTERNATIONAL TRADE: IMPLICATIONS FOR CANADIAN REGULATORS

D. Cohen

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THE INTERSECTION OF CONSUMER PROTECTION LAW AND INTERNATIONAL TRADE: IMPLICATIONS FOR CANADIAN REGULATORS

Introduction

Any analysis of domestic consumer protection law and international trade must recognize that the relationship between law and trade is reciprocal. The trade effects of domestic law are no less significant than the complementary influence of international trade on domestic consumer protection law and the regulatory process in Canada. It is my objective to describe and evaluate the intersection of these apparently independent, legal, political and economic phenomena in the context of the trade relationship between Canada and the United States.

During the past quarter century we have experienced a massive expansion in the extent and nature of governmental and judicial intrusion in private market relationships. This regulatory supervision has been designed either to remedy market dysfunction, or to replace the private market entirely. In the case of consumer protection law, market regulation may take the form of mandatory information-transfer requirements, product bans, mandatory product standardization requirements, judicial awards of compensation in product liability suits, product approval programs, and a variety of other less significant measures. These actions, whether judicial, bureaucratic or legislative in origin, may influence international trade sometimes deliberately and in unexpected ways. Domestic law may prohibit the import of products, increase production or marketing costs of imported goods, influence the export of investments, or create incentives for the export of hazardous products. Simultaneously, international trade developments may result in the incorporation of foreign standards in Canadian law, and international treaty obligations may radically influence both the substance of domestic consumer protection law and the regulatory process through which it is created.

It is difficult, if not impossible, to estimate the impact of domestic consumer protection law on international trade even if limited to United States-Canada trade.[1] The definition of the phenomenon--domestic measures, whether legislative, bureaucratic or judicial, which have an effect that is equivalent to a quantitative restriction on trade[2]--will, in theory, include all national and state/provincial laws and administrative practices that have the effect of increasing costs or decreasing profits of imported goods.[3] It is difficult even to catalogue or describe those measures, let alone determine and value their impact.[4] Simply put, it is not feasible to value all "governmental regulatory measures and private practices [other than tariffs] that have the effect of restricting or modifying the volume, composition and direction in international trade."[5] However, while the impact may not be easily quantifiable, there is little doubt that increased consumer protection regulatory measures,[6] the lowering or elimination of tariff barriers,[7] and economic recession[8] may be the genesis of an increase in non-tariff barriers associated with consumer protection law. At the very least, the issue is a timely one.[9] The risks concomitant to an increased incidence of these non-tariff barriers are exacerbated in view of their subtle nature and impact, and the serious difficulties that one encounters in any attempt to monitor and challenge an alleged barrier.[10]

A large part of the difficulty that one experiences in identifying, monitoring and quantifying the impact of consumer protection law on international trade relates to the unlimited diversity of health, safety and fairness regulatory measures. Product movement across national boundaries may be affected by overt or covert discriminatory standards,[11] inconsistent and diverse standards among countries,[12] standards that are not the most cost effective to achieve legitimate national objectives, certification and approval procedures,[13] import inspection procedures and administrative practices,[14] country of origin marking,[15] advertising regulation,[16] packaging and labelling regulation,[17] the use of design rather than performance standards, uncertainty and information search costs regarding domestic law,[18] voluntary standards that are used collusively by national manufacturers to create effective barriers to entry,[19] product liability risks, overt or covert judicial discrimination, and government disclosure and freedom of information policy.

The complexity of the issue is magnified by the variety of subtle responses and effects that these potential or actual barriers evoke. Domestic consumer protection law may restrict exports in the long run by inhibiting the development of national markets yet may, in the short run, trigger the export of hazardous products to markets with less rigourous consumer protection legislation.[20] Domestic consumer protection law, by imposing liability on domestic importers or direct suppliers, may assist foreign manufacturers by reducing the risks of product liability suits which they would otherwise face.[21] In addition, domestic law may result in increased direct investment by foreign manufacturers in order to comply with packaging and labelling regulations,[22] but at the same time may motivate domestic firms to seek jurisdictions characterized by less restrictive regulatory regimes.[23] The clearest, and obviously the most significant impact of consumer protection law on international trade, is the exclusion of consumer products from the domestic market, and increased production and marketing costs to exporters of consumer goods.[24]

While the scope and impact of the relationship of consumer protection law and international trade between Canada and the United States cannot be quantified, it is imperative that an attempt be made to describe the phenomenon. First, Canadian export policy is designed, at least in part, to encourage the export of manufactured goods, and it is in respect to these goods that non-tariff barriers have their greatest impact.[25] Second, both Canada and the United States are members of international organizations that have demonstrated a policy favouring the reduction of non-tariff barriers created by product standards and related consumer protection law.[26] Finally, both Canada and the United States, as signatories to the GATT Agreement on Technical Barriers to Trade, (commonly referred to as the Standards Code) have assumed obligations to adopt measures facilitating the elimination of non-tariff standard barriers.[27]

This paper will examine the intersection of consumer protection law and international trade between Canada and the United States in four contexts. First, I will describe the potential influence of domestic consumer protection law on the export of goods produced by domestic manufacturers. Second, I will evaluate the impact of packaging, labelling and "information regulation" laws on trade between the two jurisdictions. Third, I will examine the impact of product liability law on exports of consumer goods between the two countries. Finally, I will assess the influence of product standards on international trade between Canada and the United States, with particular emphasis on the possible impact of the GATT Standards Code on domestic consumer protection law and the Canadian regulatory process. It is here that the reciprocal nature of the relationship between trade and consumer law takes on critical significance.

The Impact of Domestic Law on Exporters

Domestic consumer protection law may, by imposing additional production costs on manufacturers, adversely affect the competitiveness of a manufacturer's exports.[28] Even where firms do not export their entire production, compliance costs related to goods destined for local trade may be allocated to products destined for other than the domestic market. In many cases, it may not be economically feasible for a firm to spread compliance costs of consumer protection law over its domestic sales only. Many firms in the consumer goods industry may not enjoy the market power necessary to administer prices without a view to the activities of local or foreign competitiors, and in any event the relative quantity produced for local sale may be so small as to make it impractical not to spread the "regulatory" overhead to exports as well. Moreover, both Canada and the United States operate anti-dumping programs that focus on products sold in the export market at a price lower than the home market.[29]

Domestic law may also inhibit exports by denying or restricting development of a home market. Two recent theories of international trade have emphasized the importance of a home market to an exporter.[30] Linder's "representative demand" hypothesis--that per capita intensity of trade between two countries will depend upon the similarity of the levels of per capita income and thus on the demand structures between the two countries--holds that a country's range of exportable products is determined by "internal" demand. "It is a necessary, but not sufficient, condition that a product be consumed [or invested] in the home country for this product to be a potential export product."[31] The early stages of the "product cycle" hypothesis[32] also emphasize the importance of the home market.[33] By discouraging or preventing local production, or at least by increasing costs to domestic manufacturers, consumer protection law may, according to these hypotheses, inhibit trade.[34] It should be recognized, however, that in the case of Canada-United States trade, the "home market" may not always coincide with national boundaries thus weakening the prejudicial impact of domestic consumer protection law somewhat. Industry in Canada and the United States enjoys the advantages of proximity and a rough similarity in income structures and consumer tastes. Also, both countries have a long history of extensive trade links. Nonetheless, it is possible that smaller, financially weaker firms would depend to a greater extent upon a "home market" advantage, and thus be affected most by measures inhibiting development of a product in it, or preventing access of a product to it.

While domestic regulatory legislation may inhibit the development of exports in some cases, and perhaps in the long term, there is considerable evidence that product regulation or bans may trigger exports of hazardous products to unregulated markets. Several examples have been documented of manufacturers in the United States responding to US product safety regulations by exporting banned hazardous products to developing countries.[35] In fact, US as well as Canadian consumer protection legislation encourages the export of banned products, although recent national measures and GATT negotiations have resulted in "notification" obligations between the exporting and importing state in respect of hazardous products banned in the exporting state.[36] Although it seems that isolated instances of the export of hazardous products from the United States to Canada have been reported, extensive communication between regulatory authorities, the existence of a sophisticated Canadian consumer product safety bureaucracy, and a concern that United States citizens might be exposed to banned products exported to Canada,[37] suggest that the trade in hazardous products between Canada and the United States is considerably less than that between the United States and developing countries.[38]

Information Regulation

The least intrusive regulatory tools employed in product quality and safety regulation are public and private measures designed to ensure that specific information is provided to consumers,[39] and that information provided voluntarily by manufacturers is accurate.[40] Consumer protection measures regulating information transfer consist of advertising regulation,[41] deceptive trade practice legislation,[42] labelling requirements and judicially imposed obligations to disclose product risks. While information transfer may be associated with low compliance costs, information regulation appears consistently in descriptions of non-tariff barriers between Canada and the United States.[43] The reasons are obvious. First, Canadian labelling and consumer disclosure laws have been described by the OECD as among the most rigourous of Western nations.[44] As well, bilingual labelling requirements may impose costs (albeit minor) on foreign manufacturers.[45] Second, both Canada and the United States have adopted "country of origin" marking regulations in the case of imported goods[46]--an obvious impact of "origin" marks is to facilitate consumer selection of goods manufactured in the domestic jurisdiction. Third, product liability law obliges manufacturers to adopt reasonable measures to warn consumers of the risks associated with use of the product.[47] This duty to warn, insofar as it requires warning in the language of the consumer, may present additional costs to foreign manufacturers.[48] Moreover, if the judicial standard of care in the case of warnings is more rigourous in the United States than in Canada, it is possible that Canadian manufacturers must incur additional costs if they intend to export to the United States, while their manufacturers, if they comply with the more stringent US "warning" standards, face no additional costs and reduced risks when they export to Canada.[49]

While information regulation has been cited as a non-tariff barrier, it would seem that information disclosure is the least intrusive of regulatory measures imposed as a product of consumer protection motivations--cost of compliance studies suggest that the marginal cost of labelling is very small.[50] As well, one must keep in mind that even in the absence of legislative labelling regulation, manufacturers must comply with common law "labelling" requirements. Judges in both Canada and the United States impose a legal obligation to warn consumers of risks of personal injury and property damage associated with product use.[51] US manufacturers must, of course, provide warnings in the language of the importing market,[52] but visual warnings[53] and multilingual markets even in the United States[54] suggest that this potential judicial non-tariff barrier does not create significant trade distortions.

Of greater concern are US and Canadian "origin of goods" labelling requirements which are alleged to have a substantial impact on consumer purchase decisions.[55] Origin of goods marking obligations have been viewed by the EEC as measures that reduce consumer demand for imported goods, and thus constitute regulatory measures which reduce the "intrinsic value" of the imported goods, and thus have an effective equivalent to a quantitative restriction on trade.[56] Country of origin labelling, unless it can be justified as signalling the quality or process of manufacture of imported goods is considered, in and of itself, as a non-tariff barrier even if all products are required to be origin marked.[57] Canadian authorities have questioned the consumer protection motivation of US origin marking requirements.[58] It is equally unclear how Canadian origin marking law protects consumers in Canada.

In conclusion, one can say that the information requirements of consumer protection law, while often pointed to as non-tariff barriers would at least in the context of United States-Canada trade, appear to pose only a slight impediment to the movement of consumer goods. Bilingual labelling regulations will certainly continue to apply to goods destined for sale in Canada, even if they are justified principally on political and social grounds, and notwithstanding that the legislation may possibly represent a contravention of the GATT Standards Code.[59] Unlike the EEC Treaty which exempts technical barriers from challenge if they are justified on grounds of public morality or public policy,[60] the Standards Code exempts only those measures necessary "for the protection of human, animal or plant life or health, of the environment, or for the prevention of deceptive practices."[61] Canada will, of course, attempt to justify bilingual labelling of quality information as a necessary aspect of "deceptive practice" consumer protection law. The difference between the GATT Standards Code exception and the Treaty of Rome suggests that Canadian justification of its position on this matter will not be straightforward. Nonetheless, the political rationale for the regulation, and the apparent genesis of a Canadian packaging and labelling industry,[62] whose economic health depends on the cost impact of national labelling requirements, leads to the conclusion that labelling regulation will remain a characteristic of Canada-US trade relations for some time.[63]

Product Liability and International Trade

Product liability refers, in its broadest sense, to the legal responsibility of a manufacturer to compensate product users for losses associated with personal injuries or property damage caused by a defective product. This right to compensation developed historically through an incremental process of judicial decision-making, and in light of the common ancestry of the US and Canadian legal systems, the general doctrinal and conceptual framework of product liability laws in the two jurisdictions is very similar. In recent years, a number of provinces and most US states have enacted product liability legislation that modifies the judicially-crafted common law rules in several respects. It is important to recognize, nonetheless, that common law and statutory rules establishing the right to compensation, and thus imposing economic risks on manufacturers who introduce defective products into the marketplace are not the same in Canada and the United States.

The legal right of a consumer in Canada to obtain compensation from manufacturers is still, to a large degree,[64] premised on a demonstration of negligence or "fault" on the part of the manufacturer. Contractual claims of consumers, based upon concepts of strict liability, are available only against retail sellers in all Canadian provinces except Saskatchewan and New Brunswick. In those provinces, recent consumer protection legislation has imposed strict product liability on remote manufacturers as well as retailers.[65] By contrast, in the United States, contract actions that impose strict liability are available against manufacturers of consumer goods, including foreign manufacturers.[66] In addition, in most state jurisdictions, manufacturers of consumer goods are strictly liable in tort when they introduce dangerously defective goods into the stream of commerce.[67]

The strict liability rules applied in US courts today have been justified on several grounds. Three are of principal importance. First, is it arguable that shifting liability from the consumer to the manufacturer allows for a "better" distribution of the costs of accidents? Assigning liability to the manufacturer for accident costs caused by defective products ensures that injured consumers will be compensated, and as well, that the costs of product-related accidents will be more effectively distributed over time and product users. It is commonly argued that manufacturers can more easily insure against these risks, and more effectively internalize accident costs enabling all or part of them to be passed on to consumers.[68] Second, this orientation of product liability law has beneficial incentive effects that may reduce the frequency of product defects and related accidents. It is hoped that the legal system, by providing remedies to injured consumers and imposing financial penalties on manufacturers, will induce manufacturers who are potential (or actual) defendants to exercise care to prevent the introduction of defective products into the marketplace. The "caveat venditor" approach taken in the context of a public legal process may also have the effect of attaching "moral opprobrium" to the manufacturer's "market reputation" or product. Third, some have argued that the manufacturer has a moral responsibility to stand behind his products. While it is recognized that both the consumer and the manufacturer exercise control over safety, weight is increasingly being placed on the need for manufacturers to take measures to see that products are safe and used safely.

In recent years, product liability has been the subject of extensive study and debate. As my brief discussion of the justifications for "caveat venditor" suggests, product liability law is a subject that deals with basic problems in areas of social and economic policy, social justice and the efficient use of resources. It may very well be that the United States has adopted a strict product liability system in order to establish a private, mandatory personal injury insurance scheme to provide "automatic" compensation for personal injury losses suffered by US consumers. Canada, and most other Western economies, have developed publicly-funded health insurance programs, and thus the judiciary in these jurisdictions may not have perceived a social need for strict products liability.[69] Be that as it may, the financial impact of strict product liability law is of major significance.

The financial costs faced by unsuccessful manufacturer-defendants may include their own legal expenses, the consumer's legal costs, the wasted time of executives and company specialists devoted to the legal action and, most importantly, damages awarded to the plaintiff. Moreover, the business of the defendant will likely be affected indirectly through the impact that public legal proceedings may have on the commercial reputation of the defendant and/or its product. In consumer markets characterized by product differentiation keying on a product's brand name or the name of the manufacturer, adverse publicity can have a sizeable impact on a product's or a firm's sales.

Undoubtedly, the working of the legal system transmits easily perceptible signals to manufacturers of consumer goods who have been, or are potential, defendants (which should include all manufacturers). It is hoped that in the context of a market-orientated economy, manufacturers will respond to product liability risks by investing in accident reduction measures to the point that the marginal benefit associated with an additional accident prevention measure equals the marginal cost of the accident prevention activity. However, since preventive action in response to the stimuli of product liability law is voluntary, it is necessary to determine whether or not a manufacturer might choose to deal with the problem of product liability risk in some other way than by producing fewer defective products. The following options are conceivable alternatives:

- to adopt measures short of withdrawing a product (or not introducing a new product) that aim at eliminating or reducing the frequency of product defects (i.e. to introduce loss prevention techniques in its design, production and marketing process);
- to insure against the risk of financial loss;
- to withdraw or fail to introduce a new product into the market;
- to refrain from adopting any positive measures, accepting the product liability risks as an unavoidable cost of doing business in the hope that realized costs can be paid for out of revenue or passed on to the firm's customers or suppliers (including employees).

How does a manufacturer choose his response? What factors are taken into account? Neither question is easy to answer. Obviously the answer to the first question will turn on the manufacturer's objectives. When economists deal with this question, they employ an assumption that may reduce the complexity of business decision-making and certainly simplifies analysis of the second question--they assume that businesses are profit maximizers. While profits are undoubtedly a very important aspect of "private enterprise", the day-to-day operations and even the strategic decisions of a particular business may be as significantly affected by objectives such as maintenance or growth of market shares. This does not mean, however, that cost minimization is not a sub-objective of any business activity. Generally speaking, businesses will use some variant of cost-benefit analysis to determine which option to follow. The ultimate difficulty involved with this type of analysis is obtaining accurate measurements of items defined to be costs or benefits, and ensuring that the analysis is comprehensive.

Two factors will likely play dominant roles in any analysis intended to produce a decision to adopt a particular option--the nature of the defect and the economic impact of the option chosen by the firm. Product defects are usually categorized as being either "design" or "manufacturing" defects. Design defects are associated with deliberate decisions that define the product's performance characteristics. For example, the sedative called "Thalidomide" and manufactured under various trade names, was withdrawn from the market following evidence that, if taken in the early stages of pregnancy, it would cause serious injury to the embryo resulting in severe deformities. While effective in its intended purpose, the drug had this unanticipated side effect.[70] Another example of a possible design defect is that of a particular model of a consumer product. In McCormack v. Hankscraft,[71] a steam vaporizer with a lift-off cap was placed on a kitchen stool in a child's bedroom. During the night the child awoke and while walking through the darkened room tripped over the electrical cord connected to the cap. The vaporizer tipped over, and the scalding water flowing from the overturned vaporizer severely burned the child. While the vaporizer was manufactured in accordance with the manufacturer's specifications, the court found the design to be defective.[72] Other possible design defects include selection of a certain component material, the size of a given part, the absence of safety devices or the location of a feature.[73] Manufacturing defects, on the other hand, arise during the production process and may be the result of any one of a number of causes such as the carelessness of employees, malfunctioning machinery, a breakdown in a quality control system, or the use of a defective component part or raw material. A manufacturing defect is likely to be inadvertent in the sense that a particular defective product does not have the physical or performance characteristics expected by the manufacturer.

A recognizable difference between a design and a manufacturing defect is that the former exists in every unit of a product of a given make or kind, while manufacturing defects are more likely to exist in individual, randomly affected units or batches of a particular product. Intuitively, design defects involve a more costly adjustment than do manufacturing defects even though the financial impact of a particular specific product liability action may be just as severe for an injury caused by a product containing either defect.[74]

A manufacturer faced with a design defect may choose to alter the design of the product to remove the defect. This may involve adding a relatively inexpensive safety device such as a guard or barrier, or may necessitate a complete redesign of the product. It is even possible that the defect cannot be removed while at the same time preserving an essential performance characteristic of the product. In these circumstances, the manufacturer is precluded from choosing the first option. A manufacturer faced with a manufacturing defect may, of course, have as difficult and expensive a task before him as the manufacturer confronted with a potential design defect. While it is unlikely that preventing defects of this type from occurring would be technically impossible, it may be economically impractical to do so, for ultimately this would require a comprehensive inspection and monitoring process of enormous expense relative to the value of the average consumer product. Those isolated products with manufacturing defects that enter the market can be recalled for repair or withdrawn from the market. Alternatively, users can be warned of the defect in an attempt to reduce the likelihood of an accident occurring.

The second factor mentioned above--the economic impact of the various options--while receiving a fair amount of attention in "theoretical" discussions of product liability law, has yet to receive extensive empirical study. That preventive measures will increase unit costs of production is mentioned as a matter of routine. However, I am unaware of any study that has surveyed a specific industry regarding the cost of preventive actions (whether of the pre- or post-sale variety).[75] It seems as though most product liability policy analysts accept, as a matter of faith perhaps, that manufacturers will follow the first (or third) option to the point where preventive action is no longer cost-justified--or as one author put it, "where the marginal cost [of eliminating defects] and benefit [of eliminating defects] to the producer are equated."[76]

Thus it is difficult to evaluate the impact of product liability law on manufacturers of consumer goods. What we do know is that product liability law which currently has a "caveat venditor" approach in both Canada and the United States, represents a financial risk to virtually all manufacturers of consumer products as it is technically impossible or economically impractical to prevent all product defects. The risk represents either a potential direct financial loss, coupled with the consequences of exposing the company's name and product to adverse and potentially destructive publicity, or a certain fixed cost consisting of insurance costs and risk prevention procedures. Any particular manufacturer's response is flexible, and may include a combination of measures designed to reduce risk exposure through attempts to exchange potential costs for certain costs through some form of insurance. The manufacturer need not take any positive steps to remove product risks, as his response to the disincentives of the legal system in this context is voluntary. What route a particular manufacturer follows will very much depend upon the nature of the defect, the nature of the product and its market, and the relative economic impact of the alternative available to the manufacturer.

Before turning to the impact of consumer protection legislation on international trade in consumer goods, a brief look at the possible impact of product liability law on product innovation and variety is warranted. It is possible that strict product liability law will have the effect of restricting consumer choice by causing producers to remove "defective" product designs from the marketplace. To the extent that manufacturers choose to phase out products with "defective" characteristics, or alter a product's design to conform with judicially crafted standards, variety will be restricted. An equally significant consequence of an increase in perceived risks is the reduction in product innovation activities.[77] While no empirical work has been done on the impact of civil product liability law on product innovation, studies have been done regarding the impact on innovation of government regulation of consumer products. The impact of product liability law on firms sensitive to its deterrent effects should be in the same direction only differing in degree. It can be argued that, like regulation, product liability costs reduce the return on research and development. Measures taken to design a "safer" product, to reduce the likelihood of manufacturing defects and to better inform the user population would, presumably, increase unit production and marketing costs. There is no guarantee that these costs can be passed on by the manufacturer.[78]

So far my analysis of product liability law has implicitly assumed that the law in Canada that US manufacturers face is generally comparable to the US product liability risks to which Canadian manufacturers must respond. Nothing could be further from the truth. If one assumes that the economic risks faced by manufacturers are a function of the magnitude of potential product liability claims and the probability of a claim being pursued, it is clear beyond the slightest doubt that Canadian manufacturers exporting to the United States face far greater risks than their counterparts exporting to Canada:[79]

- US state law uniformly permits strict product liability claims to be brought against manufacturers in tort or contract.[80] Only Saskatchewan and New Brunswick have adopted strict product liability law.[81] The Canadian manufacturer exporting to a strict product liability regime must take into account a larger number of product liability claims, as the costs of litigation in a strict product liability action are apt to be lower than in a negligence suit. As well, the likelihood of success in a product liability suit is far higher in a strict liability regime than in a negligence jurisdiction.

- US manufacturers do not face contractual product liability claims in most Canadian provinces--and even where contractual claims may be brought against Canadian distributors of US products, liability is subject to contractual disclaimers in most jurisdictions.[82] Canadian manufacturers exporting to the United States face strict US contract product liability law. As well, disclaimers of liability for personal injury claims are presumptively unconscionable and thus void.[83] Finally, the United States Federal Magnuson-Moss Act[84] precludes the disclaimer of warranties implied by state law.
- US manufacturers exporting to Canada will only rarely face liability for design defects, as Canadian courts are extremely reluctant to undertake design review.[85] Conversely, Canadian exporters face the enormous risk of design defect liability in the United States and, as well, may have difficulty obtaining product liability insurance against design defect risks.
- US manufacturers face only the slightest risk of class action suits brought in Canada by Canadian users,[86] while the use of class action proceedings in US product liability claims is notorious.
- Consumer lawsuits in the United States against Canadian manufacturers are facilitated by "contingent fee" funding arrangements where legal representatives are compensated through receipt of a proportion of the product liability award recovered by their client. Through this mechanism, lawyers effectively finance a significant proportion of US product liability suits. Contingent fee arrangements are prohibited in several Canadian provinces, and substantially circumscribed in others. In general, they are not available to the same degree to Canadian consumers in proceedings against US manufacturers.

- Consumers contemplating actions in Canada against US manufacturers face the risk of cost awards under which they must pay a portion of the costs of the defendant manufacturer if they are unsuccessful in the product liability suit. This cost deterrent is not present in the United States.
- US manufacturers selling in Canada do not, to a large degree, face the risks of employee product liability claims (to the extent that those risks are borne by social insurance worker compensation plans). A large percentage of product liability claims in the United States faced by Canadian manufacturers are brought by employees.[87]
- US courts have deliberately and selectively adopted jurisdictional rules that permit the court to apply the substantive law of the jurisdiction most favourable to the US consumer in proceedings against foreign manufacturers.[88] As well, US courts have adopted rules that deliberately discriminate against alien manufacturers.[89]
- Canadian courts have limited maximum damage awards for pain and suffering to $100,000, while US courts exercise discretion to award indefinite sums amounting to millions of dollars to compensate for pain and suffering associated with personal injuries caused by defective products.[90]
- The risk of punitive damage awards in US courts faced by Canadian manufacturers is far greater than the comparable risk faced by US manufacturers exporting to Canada.[91]
- To the extent that US firms are larger than Canadian exporting enterprises, product liability laws even if comparable, would impact more severely on the smaller Canadian enterprises.[92]
- The Canadian exporter will also face the risk that a US retail seller used by a US consumer will exercise an automatic right of idemnity from the foreign manufacturer.[93]

- As well, it is fair to say that US consumers, especially in some state jurisdictions, are far more likely to commence legal proceedings as a result of "claims consciousness" than are Canadian consumers.[94]

In conclusion, the existence of "stricter" product liability laws will increase the liability exposure of a manufacturer exporting to that jurisdiction. Both the increase in liability exposure and the added costs of compliance are likely to inhibit trade. The divergencies in the substantive law, as well as in its administration and associated procedural rules, make for significant differences in liability exposure. In addition, there is no doubt that multijurisdiction litigation is more costly and uncertain than single jurisdiction litigation. Assuming that the deterrent effect of product liability law is proportional both to the "strictness" of the liability rules employed and to the probability of claims being pursued, then one would expect Canadian firms to incur substantially greater costs to reduce liability exposure by taking positive measures as a result of their decision to export to the United States than one would expect of United States firms' costs when exporting to Canada. Furthermore, if the costs of reducing liability exposure are spread evenly over the firm's output, Canadian consumers may be subsidizing both US consumers of goods exported to the United States from Canada, and US consumers of goods exported to Canada from the United States. In the instance where the risk reducing measure is insurance, Canadian consumers would be subsidizing the implicit product liability insurance coverage that accompanies products in a "caveat venditor" legal system.[95]

The relative "safety" of the Canadian market (from the perspective of a manufacturer) may, nonetheless, present offsetting benefits to Canadian firms. To the extent that Canadian manufacturers can produce two different products or implement separate quality control systems reflecting the relative difference in product liability risks in the two markets to which the goods are destined, the manufacturers which sell a substantial portion of their production in the domestic market may benefit from the lower costs associated with Canadian product liability laws. As well, Canadian consumers may benefit from the "higher" standards associated with imported US products and with Canadian products destined for export to the United States. I say "may", since it is not clear that the marginal benefits (as perceived and valued by Canadians) associated with the increased safety and insurance which characterize those products, at least equal the marginal costs associated with the internalization of the product liability risks.

What one can say is that the number, probability and magnitude of product liability risks are substantially greater for a Canadian firm exporting to the United States, than for a US firm exporting to Canada. While the enterprises may be treated in a non-discriminatory fashion by the courts in the importing jurisdiction (and even this is not always true), US exporters benefit from the conservative product liability laws in force in most Canadian provinces. The rationale for the development of strict product liability has been explained earlier. Through the imposition of damage compensation awards, we can ensure the internationalization of all costs associated with a product so that a certain quantity (q) of a product will be produced at a price (p) where the marginal cost of production equals the marginal revenue obtained through the sale of one additional product. The marginal cost of production must include all private and social costs including personal injury and property damage associated with the product. It thus becomes obvious that through the export of products to Canada, US manufacturers can externalize a cost of production to a far greater degree than if they produced for the domestic market. That is not to say that this is necessarily undesirable. It may very well be that we would be unwilling to pay for the degree of safety that a strict product liability regime would demand.

Conversely, the smaller Canadian exporter assessing the risks posed by United States consumer product liability laws may very well decide to forego exporting his product, and at the very least face marginal risk prevention and insurance costs higher than his US counterpart. He may, in the end, redesign his product in anticipation of the application of strict product liability for design defects in the United States.[96]

The GATT Standards Code: A Critique

Non-discriminatory Treatment of Imported Goods

The GATT Standards Code consists of several distinct parts, one of which parallels key provisions of the basic GATT system designed to reduce barriers to international trade, and reduce discriminatory treatment among sources of imports.[97] Specifically, under articles 2.1 and 7.2 of the Code, signatories are obligated to treat imported goods in the same fashion as domestic goods. The Preamble to the Code reinforces that central obligation. This prohibition on arbitrary and unjustifiable discriminatory measures applied to imported goods, while laudable in theory, may give rise to substantial theoretical and practical difficulties. First, since discriminatory treatment of imported goods may be "justified" under the Standards Code, states defending an alleged Code violation may demonstrate that, in fact, overt discriminatory treatment of imports results in equivalent treatment.[98] For example, Canadian selective inspection of foreign products[99] may very well be justified on the grounds first, that a proportionately higher percentage of imported products does not comply with hazardous products legislation;[100] second, that negative publicity, seizure and recall risks are much less of a deterrent to foreign manufacturers than to local Canadian manufacturers;[101] or third, that authorities are able to trade and monitor the production process of domestic manufactured goods, and cannot carry out the same evaluation in the case of imported products.[102] Thus it may very well be that discriminatory treatment of imported products is necessary simply to ensure that these products are subject to the same substantive regulation as Canadian products. Of course, it is difficult, if not impossible, to quantify the increased risks associated with imported goods, and "justifiable" discrimination permitted under the Standards Code (whatever it means) certainly will demand empirical data to support selective treatment of imports.

Of far greater significance is evidence suggesting that product safety regulations which appear to be applied impartially to domestic and imported goods may have a more severe economic impact on smaller manufacturing firms.[103] If Canadian exporters are smaller (in terms of markets, sales and capitilization) than their US competitors, the "national treatment" obligation established by the Standards Code may, in reality, impose more severe restraints and costs on Canadian exporting firms. The differential impact on smaller Canadian firms may flow from the inability of smaller firms to pass on compliance costs as easily as large enterprises;[104] the higher cost of product liability insurance for smaller firms,[105] or regulatory measures which in effect impose a uniform sales tax, a per unit burden, or a fixed cost on firms, all of which impact more severely on small firms.[106] As well, smaller firms may be affected to a greater degree by loss of economies of scale where standards force product differentiation;[107] smaller firms will have to amortize regulatory compliance costs over fewer units;[108] smaller firms may have to incur costs while larger firms may have already met the standard;[109] and smaller firms that do not enjoy the degree of vertical integration of larger firms may not be able to control product liability risks associated with component materials.[110]

While this concern with the differential impact of consumer product safety regulation on smaller firms may be particularly acute in the case of developing nations, the problem is not irrelevant to Canada-US trade relations. Finally, it has become apparent that standards which, on their face, apply equally to domestic and imported goods, may in fact offer significant competitive advantages to national firms whose interests may have been taken into account in the regulatory process.[111] It is almost impossible to ascertain when this aspect of discrimination is present. What appears to be "equal treatment" may in fact constitute discrimination. If we are concerned with the discrimination that favours smaller firms (what civil libertarians refer to as affirmative action) might very well be justified.

It is obvious that the concept of non-discrimination is not as simple as it first appears. In some cases discrimination will be justified, but Canadian regulators must, under the Standards Code, be prepared to adduce empirical data as to the rationale and perhaps efficacy of the differential treatment of imported products. In addition, the relative size of Canadian and US firms may result in the differential impact of superficially equivalent regulatory measures, and domestic firms may benefit from regulation simply by reason of their influence on the regulatory process. For these and perhaps other reasons, the signatories to the Standards Code did not limit their efforts to these "non-discrimination" provisions. The Code includes several measures designed to ameliorate the trade effects of domestic regulatory standards. These include harmonization of standards, and various measures designed to facilitate international co-operation in national standard setting processes.

Harmonization of Standards in Canada and the United States

The prohibition against the discriminatory use and application of standards found in the Standards Code is only one element aimed at reducing or controlling non-tariff standard barriers. While national treatment obligations, if followed, may help ensure that deliberate protectionist measures are avoided, divergence in the substance of standards, differences in testing and inspection procedures, and the use of local, national or regional certification marks may inadvertently or deliberately influence trade. To remove this source of distortion and expand the benefits that consumers and producers receive from standardization, national and regional standards need to be "harmonized".

Total harmonization of product standards and related activities involves three steps--the content of product standards must be made uniform; testing and inspection procedures must be designed to accord with uniform standards for testing laboratories; and, either international certification marks must be developed or joint programs established to allow local marks to be accepted in export markets.[112] Total harmonization as a universal tool is, however, likely to be impractical and may not be appropriate or necessary in many cases. It may be the "technician's impossible dream" given differences in climate, geography and felt needs for public health and safety. Harmonization may, however, be appropriate for certain goods and procedures under specificed conditions--"Recognizing the impracticality of total harmonization and the need for a broadly workable solution, numerous bilateral and multilateral compromise measures have been proposed by various organizations concerned with international product standards."[113] The development and adoption of "international standards" is seen as a means to achieve optimum levels of harmonization.

Canada participates in three international standards organizations--the International Organization for Standardization (ISO), the International Electrical Commission (IEC), and the Pacific Area Standards Organization (PASC).[114] The PASC is limited to a means of communication and exchange of ideas and is not involved in producing standards. In 1972, the Standards Council of Canada assumed responsibility for representing Canada on the ISO and IEC from the private Canadian Standards Association:

> Participation in ISO and IEC work takes one of four basic forms, participation in policy committees, participation in the technical work of developing international standards and recommendations, acceptance of technical committee secretariats and hosting of international meetings in Canada.[115]

The Standards Council is currently undertaking a concerted effort to integrate the activities of private Canadian standard writing organizations[116] with Canada's international standard setting activities, and international GATT obligations. In consultation with these standard writing organizations, the Standards Council has developed a system for managing harmonized standards work:[117] "It is the policy of the SCC that the national and international standards work in Canada be integrated to the greatest extent possible whenever Canadian practices and conditions permit." The objectives of the integration policy include a reduction of duplication of effort; the more efficient use of available resources; a reduction in the likelihood of undertaking international commitments that cannot be implemented nationally; the elevation of Canadian national standards to international standards; and the adoption of international standards, or parts thereof, into Canadian national standards. Since a national standard of Canada is a consensus standard which is submitted to the

Standards Council for approval by or through an accredited standard-writing organization, the attainment of these objectives depends upon the attitudes and resources of the private and public standard-writing agencies. It would appear that few ISO or IEC standards have been adopted as Canadian national standards despite the fact that 208 existing or draft ISO and IEC standards were recommended for adoption as national standards during the 1980-81 year.[118] During this same year, only 31 standards submitted by standard-writing organizations were approved as national standards. There is little data from which to determine the extent to which Canadian standard-writing organizations take into account international standards in preparing Canadian standards.[119]

These activities, carried out pursuant to the Standard Code's obligation to adopt international standards "where appropriate"[120] are particularly relevant to Canada-United States bilateral standard arrangements. While there are scattered examples of standards acting as non-tariff barriers between the two countries,[121] it is fair to state as a general proposition that the development of "Canadian" standards represents the explicit adoption of United States standards, with only minor modifications.[122] One US study estimated that over 50 per cent of standards used in Canada were based on United States standards[123] and one can point to innumerable examples of references to US standards in Canadian legislation and subsidiary regulations.[124]

The reasons for the adoption of "mirror image" Canadian standards, when compared to their US counterparts, are varied. First, the lack of a Canadian accident reporting system will often force Canadian bureaucrats to rely on US data; and as a general practice, the Product Safety Branch of the Department of Consumer and Corporate Affairs relies to a significant degree on the activities of its US counterpart[125] as a starting point in their own regulatory decisions.[126] Second, both Canadian and US consumer safety regulators prefer performance rather than design standards.[127] Third, the proximity of the two countries, and the extent of cross-border traffic may give rise to "bootleg" traffic in consumer goods prohibited in one country, thus justifying complementary regulatory practice;[128]

Canada has acknowledged the risk that US manufacturers may attempt to export hazardous products banned in the United States.[129]

Possibly the most significant explanation for the relative homogeneity of standards across the Canada-United States border is that Canadian industry deliberately chooses to adopt and manufacture to US standards in order to ensure access to that market.[130] This attitude results in Canadian manufacturers supporting harmonization through their participation in the Canadian standard setting process,[131] and Canadian bureaucrats adopting the view that the marginal cost of imposing complementary standards in Canada is relatively low when firms are already manufacturing to US standards.[132] As well, the export of US standards to Canada is reinforced by the importation of product design from the United States to Canadian subsidiaries.[133]

Finally, Canadian and US standard-writing organizations work closely together, formally and informally, in designing standards.[134] US representatives sit on Canadian standard-writing organization technical committees, and Canadians participate actively in the formulation of US standards. The result may very well be that the composition of US standard committees is closely mirrored by the composition of the complementary committee in Canada.[135] These incentives, as well as public and private motives towards harmonization of Canadian and US standards, are reinforced by a common legal tradition, language, culture and closely-associated communications media.[136]

The result is that, to a very significant degree, the United States has succeeded in exporting its standards to Canada. The benefit is, of course, a relatively insignificant non-tariff barrier to trade between Canada and the United States. The cost may be a loss of autonomy for both public and private Canadian standard-writing organizations. As I demonstrate in the succeeding section, it is not necessarily true that the interests of Canadian consumers and manufacturing enterprises are well served by this process. Finally, it is well known that the United States, (as well as France, Germany and, to a limited degree, Canada) have developed programs to export standards in order to facilitate the export of domestic manufactured products.[137] These points suggest that bilateral harmonization programs may represent a US response to the relative difficulty that it faces in erecting barriers to imported goods: "the size of the American market will often ensure that foreign manufacturers make the necessary adjustment to comply with American standards."[138] The deliberate and understandable response of the United States has been to export its standards, and thus to facilitate expansion of its exports into foreign markets with "American" standards. This "standards export" philosophy suggests that it might be valuable to enquire into the motives for, and consequences of, the international harmonization of standards called for in the Standards Code.

International Harmonization: Its Impact on Canadian Consumer Protection Law

As we have seen, the GATT Standards Code obliges signatories to adopt international standards as national standards "where appropriate", a departure from the international standards is justified only when it is necessary to achieve national security, environmental, health, safety and fairness objectives.[139] Thus, the homogeneity of standards between Canada and the United States is to be applied among all trading nations agreeing to the Code.

This internationalization of product safety and quality standards may be reinforced by recent UNESCO Draft Guidelines for Consumer Protection which includes a policy favouring a national obligation to ensure that levels of safety are met "through compliance with. . .international standards, and voluntary agreements". While it is too early to assess the impact of the Standards Code and associated international trade developments on Canadian regulators, there can be little doubt that the Code may engender substantial modifications in existing regulatory procedures. At the same time, harmonization of product standards, improved access to foreign standard-setting bodies (both private and public) by government and private industries, a reduction in regional discriminatory certification systems, and a capacity to influence the development of standards by international bodies may benefit Canadian exporters.

First, it becomes critical that Canadian standard-setting institutions, both public and private, articulate clearly the rationale for a departure from international standards. In many cases such as unique climatic conditions,[140] the demonstration will be straightforward. Where the distinction relates to consumer tastes or preferences, or perhaps to consumer perception or valuation of risk,[141] empirical justification for distinctive national standards may very well be impossible. Where the rationale for a distinctive Canadian standard is difficult to support empirically, one risks a successful challenge to the standard under the GATT Standards Code.

Second, the Standards Code, in providing for the integration of international standards in national law, is clearly referring to standards promulgated by the ISO and IEC,[142] which are non-governmental organizations consisting of representatives of almost all developed nations and private enterprise.[143] The difficulty is that one is unable to evaluate the substantive content of ISO and IEC product standards at this time. Until very recently, the ISO concentrated its efforts on the development of "basic" standards relating to measurement, terminology and vocabularies, standards for units, and symbols.[144] It may be argued that Canada has committed itself to adopt standards produced by an organization which has not yet demonstrated its ability in this context. The ISO simply has little experience in the development either of product performance or health and safety product standards. The Secretary-General of the ISO admits that, unlike its earlier work, product standards are controversial, and for the first time the ISO will be undertaking activities in which "commercial interests have a great deal at stake."[145]

Moreover, a decision to adopt ISO standards must recognize that commercial interests are represented to a substantial degree on ISO technical committees, through funding, and personal and technical information.[146] Most significantly, the American National Standards Institute (the ISO representative of the United States) is a commercial institution, entirely privately funded, which participates in 85 per cent of ISO technical committees,[147] and which is purposefully seeking to extend the influence of United States standards in international standardization activities.[148] Not surprisingly, the United States was a principal supporter of the GATT Standards Code in response to European harmonization developments.[149] It is true, of course, that Canada was also a supporter of the Standards Code, and a senior Canadian government official chaired the preparatory group that drafted the Code prior to the Tokyo Round of Trade Negotiations. Canadian export interests will certainly benefit from harmonization of standards and a reduction in national and regional certification barriers.[150]

International standards developed at the ISO are based almost exclusively upon the experience and expertise of industrialized nations,[151] and serious concerns have been raised as to the under-representation of developing nations,[152] consumer interest groups[153] and labour representatives[154] in the ISO standard-setting process. It is not clear how one is to determine the "public" interest on an international scale, or even how one is to ensure adequate representation of special interest consumer or labour groups.[155] Even at the national level, consumer interests are diverse, unorganized and underfunded, and lack access to necessary technical expertise.[156] The emphasis on commercial representation at the ISO, especially through the US representative (ANSI), poses the risk expressed by the National Commission on Product Safety that corporate consensus standard-setting may "result in the watering down of a proposed standard to the point that it is merely an affirmation of the status quo."[157] While this risk arises at the national level as well, it is at least arguable that bureaucrats at the Product Safety Branch may be subject to an internalized "safety imperative" which ensures that their influence on standard-setting will be biased in favour of safety benefits.[158] That influence may be absent at the ISO.

Equally disconcerting is that the development of ISO standards is characterized by excessive delay:[159] at present, an ISO standard takes an average of seven years to develop.[160] Adoption of "dated" standards poses serious risks to product innovation and development as well as to consumer safety. Any attempts to legislate "open" standards in Canadian legislation (which might ameliorate this problem) face substantial legal impediments associated with unlawful delegation of executive and legislative authority.[161] It is fair to say that most regulatory measures will be restricted to "static" rather than dynamic reference to private standards, reinforcing the historic bias of ISO standards. The delay factor is exacerbated, at least at the federal level, by concerns that legislative references to unilingual standards may be unconstitutional.[162] At the very least, translation of technical documents is both costly and time-consuming.

An additional risk that we face as a result of the Standards Code "harmonization" policy is that the international standard may not have been developed and evaluated using economic impact analysis,[163] a concern that may be resolved only through the retrospective application of socio-economic impact analysis by the federal government before adoption in Canada.[164] Other potential difficulties associated with international harmonization, which time precludes me from developing fully, relate to anti-trust violations,[165] reduction in consumer choice,[166] and block voting practices.[167]

The harmonization obligation assumed by Canada under the Standards Code should thus be perceived as posing substantial risks unless policies are developed in Canada to describe the evaluation process that must take place before international standards are adopted at the domestic level. This evaluation process must, at a minimum, ensure that the particular ISO standard-setting process (and there is no reason to think that the process is uniform over time or issues) is reviewed on the basis of the membership of the technical committees that drafted the standard, the linkages between industry and particular firms and the committee members, whether notice was given to all interested parties, whether consumer, labour and other "public interest" representatives had sufficient time, resources and knowledge to participate effectively in the standard-setting process, the question of delay and the impact of the standard on innovation, the cost-effectiveness of the standard, and an evaluation of enforcement costs where appropriate. Most importantly, the evaluation must recognize that standard-setting, especially in the area of consumer safety, does not involve only "scientific" or "technical" issues. The establishment of product performance and safety standards demands an evaluation of the ethical, economic, political and distributive consequences of scientific decisions and data. The decision to adopt product safety standards is "value-scientific."[168] Technical and medical expertise while it may be necessary to ensure responsible decision-making is not sufficient. The issue is often clouded by substantial intractable uncertainties relating to "acceptable" levels of risk, and the interpretation and evaluation of scientific data which may not point clearly in one direction. In those circumstances, it is important that the regulator acknowledge whether consumer safety is an imperative value--that is, whether it is the reponsibility of the product supplier or manufacturer to persuade the regulator that the standard meets the particular health and safety objective at issue.

The Standards Code and the Canadian Regulatory Process

The most common criticism of the Standards Code is that it exempts from harmonization obligations, those domestic standards intended to achieve legitimate state objectives relating to health, safety and the environment.[169] The Preamble to the Code specifically recognizes domestic sovereignty to adopt measures "for the protection of human, animal or plant life or health, of the environment or for the prevention of deceptive practices", and article 2.2 permits a state to depart from international standards when they are "inappropriate. . .for such reasons as. . .the prevention of deceptive practices, protection for human health or safety, animal or plant life or health, or the environment."

These explicit exempting provisions require that one distinguish whether a particular measure has protectionist or consumer safety objects, and appear to create a categorical distinction between permissible "consumer safety" measures, and prohibited non-tariff barriers.[170] It must be acknowledged that most consumer protection measures will have both effects (if not necessarily, objects); and that categorical distinctions are entirely artificial.[171] The decision to exempt a particular domestic measure should depend on a balancing of its benefits against its impact on international trade.[172]

A second possible criticism relates to the alleged intrusion of the Standards Code on domestic sovereignty to determine the "value of human life" in establishing domestic standards, admittedly involving private and social costs designed to reduce the risk or personal injury to specific sectors of the population. Experience with the implementation of the Treaty of Rome,[173] as well as the terms of the Standards Code itself, suggest that the Code does not interfere with domestic authority to determine national safety, health and fairness objectives. It seems, however, that the Code may have two significant consequences to domestic consumer protection measures. First, any state that seeks to rely on the Code's health, safety and fairness exemption should be prepared to adduce empirical evidence demonstrating the social evil to which the regulatory measures were directed.[174] Second, and of far greater importance, is that under article 2.1 of the Code, signatories may not adopt measures that have the "effect of creating unnecessary obstacles to international trade". This, of course, establishes an implicit requirement that the measures must be "necessary" to achieve the stated objectives.[175] Arguably, the Standards Code requires that the measures adopted by the relevant state be "proportional" to the gravity of the social evil to which the measures are directed, and that alternative regulatory measures equally effective and less restrictive, are not available.[176]

Thus the Standards Code does not attempt to interfere with the degree of protection that state law seeks to achieve for its local population of consumers.[177] Rather, the Code in article 2.1 may require that the most cost-effective alternative available to achieve that end be adopted. The Code does not mandate international review of state decisions balancing non-economic health and safety benefits against international economic trade considerations;[178] the Standards Code is not concerned with legislative ends, but with the review of legislative means.[179] Nonetheless, the nature of the obligation assumed under the Code's provisions, while it may not interfere with state authority to establish regulatory objectives, may have a significant impact on the choice of regulatory tool. This impact points to the direct intersection of the Standards Code and the domestic regulatory process--an intersection that comprises the regulatory process as well as substantive consumer-protection legislation.

The "proportionality" requirement[180] of the Standards Code, if that is how it is interpreted and applied, suggests that domestic consumer-protection legislation in order to comply with the Code, be the most cost-effective and least intrusive[181] measure necessary to achieve the legitimate social objective enunciated in the Code as a permissible justification for the establishment of measures with non-tariff barrier consequences. This requirement, coupled with an obligation to adduce empirical evidence of the legitimate domestic state objective sought to be attained by the consumer-protection measure,[182] establishes an international obligation that reinforces existing Canadian Treasury Board policy guidelines mandating socio-economic impact analysis in the case of all health, safety and fairness regulations.[183] Indeed it may go further. Given a permissible health, safety and fairness objective, the federal government must choose the least intrusive measure to attain that end. Everything else being equal, this policy may demand "information" regulation which is unanimously considered less intrusive than either design or performance standards, or product bans.[184] "Regulation by disclosure" which not only is less costly to industry, but is associated with reduced enforcement and policing costs, and increased consumer choice, has been advocated as a deregulation technique in the United States.[185]

This implicit reinforcement of federal deregulation initiatives in both Canada and the United States is joined by an explicit Standards Code obligation that directs signatories to adopt performance standards in preference to design standards in domestic consumer protection legislation.[186] While it has been argued that performance standards are associated with significant "deregulation" benefits,[187] any decision to adopt standards in Canada[188] must take into account the considerable risks associated with performance standards:

° performance standards may fail to take into account the long-term properties of the product;[189]

- performance standards may entail significant development costs;[190]
- performance standards require the development and evaluation of test methods to ensure compliance;[191]
- performance standards may be expensive to administer and enforce;[192]
- performance standards may be inappropriate for safety standards due to the necessary design freedom that may result in the introduction of unknown components into the product; and
- performance standards may be inappropriate in the context of "interconnection" standards.[193]

The Standards Code directive favouring performance standards is not, of course, absolute. Nonetheless, it is clear that the rationale and empirical data justifying departure from the performance standard approach must be developed in Canada.

The regulatory process in Canada, as in other signatory countries, also stands to be transformed through the detailed "transparency" provisions of the Standards Code.[194] These provisions, which promote adequate notice and opportunity to comment on measures that depart from the Code's directions, are designed to reduce the costs of uncertainty created by foreign standards, and to permit potentially affected firms and states to make representations to the particular government which is considering the introduction of measures that may affect the firms' or states' trade interests.[195] The transparency provisions acknowledge the significant influence of special interest groups in the establishment of product safety and health measures and attempt to ensure some degree of input into the regulatory process of foreign firms and states. While it is unlikely that a national government will openly trade off safety and health benefits in the interests of foreign manufacturers, the Standards Code attempts, through its "notice and comment" provisions, to facilitate planning by foreign firms, to reduce the costs of uncertainty, and perhaps to allow affected firms and states to influence standard-setting.[196]

The transparency provisions with their emphasis on participation and notification in the regulatory process ensure that regulators become sensitive to interest groups not previously involved in the process.[197] There is little doubt that this will impose additional administrative costs on Canadian regulatory authorities, but more importantly, will promote a far greater degree of participation by domestic consumer and other special interest groups in a previously "closed" administrative process.

Conclusion

The intersection of consumer protection law and international trade between Canada and the United States is characterized by a startling absence of non-tariff barriers associated with standards. However, extraordinarily rigourous US consumer product liability laws, reinforced by procedural reforms that facilitate product liability claims, do pose substantial risks to Canadian manufacturers exporting to the United States. Conversely, the traditional laws in most Canadian provinces provide a product liability "haven" for US exporters. It is not clear, beyond anecdotal description of product redesign decisions, that product liability risks faced by Canadian exporters cannot be spread through insurance. Nonetheless, the relative size of Canadian firms, and discriminatory product liability "jurisdiction" decisions, suggest that Canadian exporters face considerably greater risks exporting to the United States than do US firms exporting to Canada. At the very least, Canadian regulators should assess whether product liability legislation and associated procedural reforms may not be justified in Canada. The externalization of costs by US firms, and by subsidiaries of US firms operating in Canada, would seem to be entirely unsupportable as a matter of public policy. Very simply, reduced exposure to product liability risks in Canada permits US firms to externalize a cost of production that ought to be reflected in the price of the goods sold. While the existence of comprehensive social and medical insurance plans, and a judicial philosophy of individualized corrective justice may explain the retention of fault-based systems of tort liability in Canada, one must question the merits of retaining an accident compensation system which insulates foreign firms and foreign-controlled subsidiaries from a substantial proportion of the costs associated with the goods they manufacture and distribute. Certainly, Canadian firms exporting to the United States do not enjoy similar protection.

A review of the available literature suggests that labelling legislation has been the source of a number of complaints of non-tariff barriers between the two countries. It seems, however, that labelling legislation does not impose substantial costs on imported goods to Canada. As well, the labelling legislation appears to have contributed, to some degree at least, to the development of a Canadian packaging and labelling industry. Finally, one might argue that bilingual labelling legislation is not obviously within the scope of the legitimate social objects established under the GATT Standards Code. Nonetheless, in view of the Canadian government's position on a national policy of bilingualism and the establishment of a Canadian "marginal" manufacturing industry, it would seem likely that packaging and labelling regulation will continue as an irritant (albeit minor) between Canada and the United States.

Possibly the most significant finding of this study is the almost perfect homogeneity between the two standard systems in Canada and the United States. It is fair to say that there is, in fact, a North American standard system. Our common legal, linguistic and cultural history, the interchange of participants in the standard setting bodies, the reliance of Canadian regulators on United States accident data, the close co-operation between our respective bureaucracies, and the presence of related firms on standard writing organizations in both countries, has resulted in US and Canadian standards and standard systems that are very similar to one another. The "North American Standard" significantly reduces the potential for non-tariff barriers between the two countries.

This phenomenon would seem to be preserved in the GATT Standards Code which the United States apparently intends to employ as a vehicle to export its standards beyond the confines of the North American continent. Canada's response to the GATT Standards Code must be sensitive to the implications of a system which may facilitate the export of US (and thus to a significant degree, Canadian) standards. The harmonization obligation under the Code suggests that Canadian regulators should be prepared to assure that Canadian interests are served either directly, or indirectly, in the international standard-writing process. The development of international product standards is in its infancy, and Canadian interests must be protected through the development of international standards that will facilitiate Canadian exports, and which can be met with a minimum of adjustment costs by Canadian firms. Equally important is the negotiation of bilateral standard agreements with the United States that will support bilateral harmonization and may go some way towards the development of ISO standards which, while influenced by the United States, are sensitive to Canadian interests. In a narrow sense, bilateral negotiation may serve to resolve conflicts about specific standards and administrative barriers between the two countries.[198]

At the same time, Canadian consumer interests will be served only if Canadian regulators, operating under a significant "safety imperative" monitor the international standard-setting process. Standard-setting does involve considerable scientific and technical expertise, and it is acknowledged that scientific "negotiation", both formal and informal, may go a long way towards reducing non-tariff barriers.[199] Nonetheless, consumer product standard-setting introduces economic, social, ethical and political values into standard development, and thus the effective participation of potential user and labour groups must be ensured. The membership of the international technical committees having primary responsibility for standard development must be monitored and evaluated as a prerequisite to the adoption of the international standard in Canada. Existing standard-writing organization procedures[200] suggest that the executive of the committee should not be a representative of a producing enterprise, or perhaps in the case of the ISO, that the executive should not be a representative of an exporting country. As well, the membership of the technical committees should consist of a majority of "consumer" or "user" or "importer" interests. Non-technical participants should have access to independent sources of information, and scientific and technical opinions.[201] The process of decision-making must also be evaluated either through an analysis of an accurate record of the standard-setting process, or ideally through discussions with participants. The purpose of this review is to assure that economic and technical considerations were not weighted to a degree that overwhelmed product safety and health considerations. Valuation of life and risk of death and injury, is never an easy task. When the additional element of the international trade environment is introduced, the process must bear close scrutiny before its results are adopted in domestic legislation or private standards.

A similar evaluation must take place prior to a decision to adopt performance rather than design standards under the Standards Code, especially in light of the risks to consumer safety, as well as the increased regulatory costs associated with the former. The impact of the Standards Code on the substance of domestic legislation, and on the openness of the regulatory process, suggest that decisions relating to implementation of the Code must take into account the interests not only of the international trade bureaucracy, but of consumer and labour groups, and of the consumer product safety bureaucracy as well.

Finally, serious considerations must be given to the development of a "tariff equivalent" for non-tariff barriers created by domestic consumer protection laws.[202] Data describing the effect of a particular measure on marginal unit costs of production and marketing are difficult to obtain; and where more than one country has established differential standards it may be difficult to disaggregate one impact assessment from another. Nonetheless, without information describing the current impact of foreign consumer protection law on Canadian trade, and without a quantitative descriptive measure of the impact of particular barriers, it may be difficult if not impossible to challenge alleged barriers established by others, or to defend ourselves from those same challenges.

Notes

1. It is generally agreed that empirical measures of non-tariff standard and product safety barriers are unavailable for Canada. Steven Globerman, U.S. Ownership of Firms in Canada: Issues and Policy Approaches (Montreal: C.D. Howe Research Institute, 1979) at note 10; Donald J. Lecraw, Voluntary Standards as a Regulatory Device, Working Paper No. 23, Regulation Reference, (Ottawa: Economic Council of Canada, 1981) at 39. While empirical data on the trade effects of consumer protection laws and product standards may be lacking, there have been attemps to assess the impact of other kinds of non-tariff barriers. See Glenn P. Jenkins, Costs and Consequences of New Protectionism: The Case of Canada's Clothing Sector (Ottawa: North-South Institute, 1980).
2. See William Cline et al., Trade Negotiations in the Tokyo Round: A Quantitative Assessment, (Washington D.C.: Brookings Institution, 1978) at 201.
3. R. Plender and J. Usher, Cases and Materials on the Law of the European Community (1980) at 322. European Economic Community Directive 70/50 describes measures equivalent to quantitative restrictions as "any measure which has the effect of lowering the value of the imported product". See Peter Oliver, Free Movement of Goods in the E.E.C., (London: European Law Centre, 1982) at 59, 60. Procureur du Roi v. Dassonville, 1974 2 C.M.L.R. 436.
4. Of course, the motive or purpose of the measure is not relevant, but that simply expands the scope of the inquiry. See Oliver, Free Movement, at 60.
5. C. Pestieau and J. Henry, "Non-Tariff Trade Barriers as a Problem in International Development", Can. Econ. Pol. Comm. (1972) at 55.

6. See Cline et al., Trade Negotiations at 62, 201.
7. The elimination of tariff barriers may force protectionist governments to adopt less obvious tools. As well, as tariffs drop, goods which were previously excluded by high tariffs will continue to be excluded by newly discovered pre-existing non-tariff barriers. See P.E. Sweeney, "Technical Analysis of Technical Barriers to Trade" (1980) 12 L. and Pol. in Int'l Bus. 179, at 187.
8. The United States experience during the 1930s is the best example of this phenomenon. Pieter Slot, Technical and Administrative Obstacles to Trade in the E.E.C., (Leyden: A.W. Sijthoff, 1975) at 131-132. Minutes of Proceedings and Evidence of the Standing Committee on Finance, Trade, and Economic Affairs, 29 January 1981, Vol. 35, at 32.
9. See Economic Council of Canada, A Time for Reason: Fifteenth Annual Review 1978, (Ottawa: The Council, 1978) at 33.
10. Report of the Standing Committee on Foreign Affairs on Canada-United States Relations, Vol. II, Canada's Trade Relations with the United States, (1978) at 87. Sweeney, "Technical Analysis" at 187.
11. Most common are standards which are apparently non-discriminatory but which are met more easily by domestic industries. Sweeney, "Technical Analysis" at 183.
12. Inconsistent standards will certainly increase design, information, and manufacturing costs, and may, in some cases, close the market to non-conforming products. See J. Groetzinger, "The New GATT Code and the International Harmonization of Product Standards" (1975), 8 Cornell Int'l. L.J. 168 at 169; F.A. Weil and N.D. Glick, "Japan, Is the Market Open? A View of the Japanese Market Drawn from Corporate Experience" (1979), 11 L. and Pol. in Int'l Bus. 845; D.J. Lecraw, Voluntary Standards at 81.
13. Oliver, Free Movement of Goods at 89.
14. Ibid., at 92.

15. E.C. Comm'n v. Ireland, 1982 1 C.M.L.R. 706; Oliver, Free Movement of Goods at 106-7.
16. See E.C. Directive 70/50, Article 2(3)(m). In E.C. Comm'n v. France, 1981 2 C.M.L.R. 743, at 758 the European Court of Justice held that advertising regulation was equivalent to a quantitative restriction on imports as it had the effect of restricting the volume of imports as a result of its impact on marketing prospects.
17. See E.C. Directive 70/50, Article 2(3)(j); Frietje, 1981 3 C.M.L.R. 722.
18. Uncertainty associated with the applicability of foreign consumer protection law, the likelihood and nature of legislative or regulatory reform, and with local, provincial and state law imposes considerable risks on foreign manufacturers. See GATT, "Multilateral Trade Negotiations", Part 3 of the Non-Tariff Measures: Standards Involving Imports and Domestic Goods, 14 February 1974, at p. 3, 4 and No. 272; Pestieau and Henry, "Non-Tariff Trade Barriers" at 56. As well, domestic manufacturers have the ability to influence the standard setter as an attribute of being located in the same jurisdiction. See Cline et al., Trade Negotiations at 201.
19. See J.C. Shaul and M.J. Treiblcock, "The Administration of the Federal Hazardous Products Act" (1982), 7 Can. Bus. L.J. 2, at 31; Lecraw, Voluntary Standards at 78.
20. See note 35.
21. See G.M. Gregg and T.D. Tzoraras, "The Liability of Manufacturers and Importers under the Trade Practices Amendment Act 1978" (1979), 10 Fed. L. Rev. 398, at 407-9.
22. Apparently, the existence of metric packaging and labelling regulation in Canada has resulted in the development of Canadian "packaging" operations. H. Edward English and Robert R. Owen, The Role of Marketing in the Concentration and Multinational Control of Manufacturing Industries, Research Monograph No. 11, Research Branch, Bureau of Competition Policy, (Ottawa: CCAC, 1981) at 124.

23. M.J. Marks and H.B. Malmgrem, "Negotiating Non-Tarriff Distortions to Trade" (1975), 7 L. and Pol. in Int'l Bus. 327, at 394.

24. These costs may include more expensive parts or materials, additional parts, a higher percentage of more expensive material, increased capital expenditure on machinery, increased investment in quality control systems, modification costs as plant and equipment are prepared to produce products for export, information search costs, increased marketing costs and the foregone benefits of economies of scale as the production process must be modified to meet a variety of national requirements. The collection and assessment of such costs, even for a particular industry raises insurmountable difficulties. See Slot, Technical and Administrative Obstacles at 61.

25. The development of "world product mandates" in Canadian manufacturing enterprises, encouraged under the Foreign Investment Review Act S.C. 1973-74, c. 46, as amended by S.C. 1976-77, s. 52 presupposes that both tariff and non-tariff product standard barriers will not preclude export of manufactured end-products. See Robert Donaldson, "Foreign Investment Review and Canadianization" in Corporate Law in the 80s, by the Law Society of Upper Canada, Special Lectures 1982. (Don Mills, Ont.: R. DeBoo Publishers, 1982) at 506; "Aerospace firms confident of niche in world markets", Globe and Mail, 17 November 1980 at B1; "Westinghouse shifts emphasis to product mandates for units", Globe and Mail, 2 December 1980 at B9; "Approved by FIRA, Apple targets big sales rise", Globe and Mail, 3 May 1982 at B2; Science Council of Canada, Working Group on Industrial Policies, Multinationals and Industrial Strategy: The Role of World Product Mandates (Ottawa: Supply and Services Canada, 1980); David Rutenberg, "Global Product Mandating" in International Business: A Canadian Perspective, by David C. Dhawan et al., (Don Mills, Ont.: Addison-Wesley, 1981) at 591-3.

26. See for example, "O.E.C.D., Recent Developments, Organization for Economic Co-operation and Development, Regulation of Chemicals--In a Council Decision, the O.E.C.D. Has Adopted Provisions Designed to Protect Human Health and the Environment Without Creating Barriers to International Chemicals Trade", (1982) 12 Geo. J. of Int'l & Comp. L. 95 at 98; O.E.C.D. Mutual Acceptance in the Assessment of Chemicals, 12 May 1981, O.E.C.D. Doc. C(81)30; O.E.C.D. Observer (February 1971). More generally, the O.E.C.D. convention, Article 2(d), states that members will co-operate to reduce obstacles to international trade in goods and services. See Slot, Technical and Administrative Obstacles at 117, 118. In 1981, the United Nations Economic and Social Council recommended to member states that they should develop national standards relating to product safety, where possible, adopt and implement relevant international standards as criteria for product safety and quality, and where necessary, prescribe a temporary standard lower than the generally accepted international standard. See United Nations Economic and Social Council, International Co-operation and Co-ordination Within the United Nations System, Consumer Protection, E/1981/75 at 29.

27. The Agreement on Technical Barriers to Trade commonly referred to as the Standards Code was concluded at the Tokyo Round of trade negotiations. It came into effect on 1 January 1980. The complete text of the Code is available as a publication of the General Agreement on Tariffs and Trade (1979), and is reproduced in GATT, Basic Instruments and Selected Documents, Twenty-Sixth Supplement, (Geneva: GATT, 1980). The negotiations leading to the adoption of the Code, and a brief description of its more significant provisions is contained in GATT, The Tokyo Round of Multinational Trade Negotiations: Report by the Director-General of GATT, (Geneva: GATT, 1979) at 62-68. There have been several excellent surveys of the Standards Code including one whose focus is on Canada. See Ivan Bernier, "Product Standards and

Non-Tariff Obstacles: The GATT Code on Technical Barriers to Trade" in Non-Tariff Barriers After the Tokyo Round, edited by J. Quinn and P. Slayton, (Montreal: IRPP, 1982), at 195-224. See also, R.W. Middleton, "The GATT Standards Code" (1980), 14 J.W.T.L. 201, at 210; Groetzinger, "New GATT Code"; J.H.J. Bourgeois, "The Tokyo Round Agreements on Technical Barriers and on Government Procurement in International and E.E.C. Perspective" (1982), 19 C.M.L.R. 5; R.E. Sweeney, "Technical Analysis"; A. Blair, "Prospects for Implementation of the GATT Standards Agreement in the United States" (1980) 20 Virg. J. Int'l L. 699.

28. The impact of consumer protection law on the cost-competitiveness of a manufacturer's exports would seem to be a function of, first, the incurred compliance costs of law (which may vary with firm size and the nature of the defect/compliance measures); and, second, the necessity of the firm passing these incurred costs on to consumers in the export market.

29. See Trade Act of 1974, Pub. L. No. 93.618, 88 Stat. (1978) 19 U.S.C. ss. 2101-2487 (1976); Michigan Y.B. of Int'l Legal Studies, Vol. I. Antidumping Law: Policy and Implementation; Anti-dumping Act, R.S.C. 1970, c. A-15, s. 9(1)(c), and Anti-dumping Regulations, Cons. Reg. of Canada (1978) c. 298, reg. 15; Rodney de C. Grey, "The Development of the Canadian Anti-Dumping System" in Can. Econ. Pol. Comm. (1973) at 74.

30. For a discussion of "old" and "new" theories of international trade and production, see Richard Caves and Ronald Jones, World Trade and Payments: An Introduction (Boston: Little, Brown, 1973), Part Two; Robert Baldwin and J. David Richardson, International Trade and Finance: Readings, (Boston: Little, Brown, 1974) at 1-4; and for a more advanced discussion, Miltiades Chacholiades, International Trade Theory and Policy, (New York: McGraw-Hill, 1978).

31. Staffan Burenstam Linder, An Essay on Trade and Transformation, (New York: Wiley, 1961) at 88.

32. See R. Vernon, "International Investment and International Trade in the Product Cycle" (1966), 80 Quarterly J. of Econ. 190; L.T. Wells, "A Product Life Cycle for International Trade?" J. of Marketing 32 (No. 3 1968): 1-6.

33. Caves and Jones, World Trade and Payments at 221. The authors emphasize the role of the innovator in addition to the home market. The experience of the pharmaceutical industry in the United States is that regulation, in particular, discourages innovation. See H.G. Grabowski, J.M. Vernon and L.G. Thomas, "Estimating the Effects of Regulation on Innovation: An International Comparative Analysis of the Pharmaceutical Industry" (1978), 21 J. of L. & Econ. 133.

34. The "home market" is also a factor. See, for example, the infant industry argument, in Caves and Jones, World Trade and Payments at 260-1, 556-7.

35. D.A. Bryan, "International Consumer Protection: Export of Hazardous Products from the United States" (1980), 4 A.S.I.L.S. Int'l L.J. 1; Note, B. Vagliano, "Any Place but Here: A Critique of United States Hazardous Export Policy" (1981), 7 Brooklyn J. Int'l L. 329; E. Shuman, "Potentially Hazardous Merchandise: Domestic and International Mechanisms for Consumer Protection" (1983), 16 Vand. J. of Tran'l L. 179, at 184-91.

36. See Consumer Product Safety Act 15 U.S.C. s. 2067(a)(i) (West Supp. 1980). Recently the Act was amended to require notification of foreign importing governments of the existence of the hazardous product ban. See R.D. Bishop and P.D. Reynolds, "An Export Primer: Legal Aspects of Exporting from the United States" (1982), 2 Houst. J. Int'l L. 333 at 355. See also Toxic Substances Control Act 15 U.S.C. s. 2611(b). In Canada, the Hazardous Products Act R.S.C. 1970, c. H-3, s. 3 permits the export of products banned from the domestic market. Ronald Hirshhorn, Product Safety Regulation and the Hazardous Products Act, Regulation Reference, Technical Report No. 10, (Ottawa: Economic Council of Canada), at 41. See GATT/Ministerial Declaration, document L/5424, adopted 29

November 1982.

37. See Bryan, "International Consumer Protection" at 12-13 and at 17; P.B. Seferovich, "United States Export of Banned Products: Legal and Moral Implications" (1981), 10 Den. J. Int'l L. and Pol. 537, at 540, 545, and 558; US Government Accounting Office, Better Regulation of Pesticide Exports and Pesticide Residues in Imported Goods is Essential C.E.D. 79-43 (Washington: US G.A.O., 1979) at 52-53. As well, there is evidence that the risk to the American manufacturer of a product liability suit instigated by a developed country consumer is far greater than that by a developing country consumer. See Vagliano, "US Hazardous Export Policy" at 361. The US policy of notifying foreign governments seems to be most effective in the case of countries such as Canada. Vagliano, "US Hazardous Export Policy" at 335, 352-53; 45 Fed. Reg. 53056 at 53059 (1980); Seferovich, "US Export of Banned Products" at 555.

38. Exports of banned products by the United States were estimated in 1981 at US $1.2 billion annually. D. Fouquet, "Campaign to protect Third World Consumers", Financial Post, 1 August 1981 at 10.

39. It is generally accepted that regulation of product safety may consist of liability in product liability suits, of mandatory design standards, mandatory performance standards, and disclosure of information. Information disclosure, since it does not interfere with product design decisions and is simply intended to correct market dysfunction consisting of either incorrect information or under-investment in information acquisition, is generally agreed to be the least intrusive of the three regulatory tools.

40. Regulation of information transfer to a large degree consists of regulation of advertising. "Advertising" refers to information transferred to a consumer separate from the transfer of the product or service which is the object of the consumer transaction. Because the information is disseminated separately from the consumer product, the regulatory impact of advertising controls has only an indirect impact on the international traffic

in consumer goods--that is, the goods themselves are not subject to regulation; but demand for the goods may be substantially influenced by advertising regulation.

41. The federal governments in both Canada and the United States have enacted legislation which requires that all information disseminated for the purpose of promoting business or commercial interests be accurate. The Canadian Combines Investigation Act R.S.C. 1970, c. C-23 s. 36 as amended by S.C. 1974-75, c. 76, imposes criminal sanctions on a variety of misleading advertising practices. Under section 36(2) where the person who has engaged in the deceptive advertising is outside of Canada, the person who imported the product containing the offending material is deemed to have made the representations himself. The primary US legislation regulating advertising is the Federal Trade Commission Act, 15 U.S.C. s. 41 et seq. While section 5 of this Act regulates practices essentially identical to those subsumed under section 36 of the Canadian legislation, the remedial tools available to the Federal Trade Commission are far more varied than the fines and imprisonment available under the Canadian legislation. See Donald P. Rothschild and David W. Carroll, Consumer Protection Reporting Service I (1981) at 96.

42. The Federal Trade Commission Act, together with state unfair trade practice legislation prohibit any activity that would tend to lead a consumer into making an error of judgment regarding a consumer transaction. Legislation in British Columbia, Ontario, Alberta, Saskatchewan, Prince Edward Island and Newfoundland establishes similar requirements of information disclosure under provincial trade practice legislation. For all intents and purposes, the state and provincial legislation is identical, although it is fair to say that the US state legislation permits more efficient enforcement and offers a broader range of consumer remedies.

43. See Standing Committee on Finance, Trade and Economic Affairs, Canada, Minutes of Proceedings and Evidence of the Standing Committee on Finance, Trade and Economic Affairs, 17

February 1981, Vol. 38 at 8, 9 and 26 February 1981, Vol 39 at 8. Rein Peterson and Mari Peterson, The Impact of Economic Regulation and Paperwork: Is Small Business Being Crushed? Working Paper No. 24, Regulation Reference, (Ottawa: Economic Council of Canada, 1981) at 103. US commentators have made the same point. See David Hemenway, Standards Systems in Canada, the U.K., West Germany, and Denmark: an Overview, prepared for the National Bureau of Standards, US Dept. of Commerce, N.B.S./G.C.R. 79-172 (Washington: National Bureau of Standards, 1979) at 3. The problem may arise within national boundaries, where the legislative authority of federal states includes the power to enact packaging and labelling laws. See P.M. Holt, "Food Packaging and Labelling" in Consumer Projection Law and Theory by A.J. Duggan and L.W. Darvall, (Sydney: Law Book Co., 1980) at 60, 61.

44. See Hirshhorn, Product Safety Regulation at 59.

45. The point has been made, however, that labelling, marking and packaging requirements are not viewed as substantial non-tariff barriers by exporters in the United States. See MTN Studies, Volume 6, Part 3, "Agreements Being Negotiated at the Multilateral Trade Negotiations in Geneva"--US International Trade Commission Investigation No. 332-101. Analysis of Non-Tariff Agreements, Agreement on Technical Barriers to Trade, (1978) at 163, 168. At the same time, while compliance costs for a specific, individual labelling requirement may be low, it is quite possible that the aggregate costs of meeting divergent labelling requirements in a number of markets is substantial.

46. See, US Customs Service, Importing into the United States (Washington: Dept. of Treasury, US Customs Service, 1981) at 51-546; 19 U.S.C. 1304 and see 19 C.F.R. 134 et seq. See generally, Jeremiah J. Spires, Doing Business in the United States, (New York: M. Bender, 1978-), Vol. II, at para 33.02(3). The Customs Tariff Act, R.S.C. 1970, c. C-41, and the "Marking of Imported Goods Order", Cons. Regs. of Canada (1978) c. 535 as amended; H. Howard Stikeman and R. Fraser Elliot, Doing

Business in Canada (Toronto: DeBoo Pub., 1980) at para. 11.03(3).

47. The duty to warn in Canada is based upon liability for failing to take reasonable care to disclose risks of personal injury or property damage. See Lambert v. Lastoplex Chemicals Co., [1972] S.C.R. 569. In the United States, the duty to warn, while similar in many respects, may in some jurisdictions impose strict liability on suppliers of consumer goods who fail to disclose product risks. See Interagency Task Force on Products Liability, Selected Papers Volume 2 (Washington: US Dept. of Commerce, 1978) at 61; C.C.H., Products Liability, Vol. I at 1511.

48. See M.T.N. Studies.

49. I develop this point in some detail in Part 3 of this paper.

50. See M.T.N. Studies.

51. Thus even if legislative intervention were removed, US manufacturers would still be faced with judicial "duty to warn" product liability suits requiring warnings of personal injury risks in the language of the consumer market. See J. Siegmund, "Current Dev Trade Negotiations in Geneva, U.Selopments in Product Liability Affecting International Commerce" (1982), 4 J. of Prod. Liab. 109, at 110.

52. There do not appear to be any Canadian cases decided on this point but the matter does not appear to be the subject of debate.

53. It is generally believed that "visual" warnings are the most effective modifiers of consumer behaviour. See Hirshhorn, Product Safety Regulation. The use of visual or symbolic warnings permits the manufacturer to export to a range of markets without being obliged to invest in costly relabelling measures. See M.J. Vernon, "Consumers Product Safety" in Duggan and Darvall, Consumer Protection Law and Theory (pp. 87-102) at 96.

54. Thus even if bilingual labelling was not required by statute, it is reasonably certain that the judicial duty to warn, and market considerations would result in bilingual labelling at least in Quebec. See Prevention and Defense of Manufacturers' Products

Liability (1979) at 194.

55. See note 46. The additional manfacturing costs associated with this requirement, the concomitant reduction in consumer demand associated with implicit "Buy American" consumer responses, and delays associated with border inspections of imported products, have been pointed to Canadian authorities as imposing barriers to the importation of Canadian products into the United States. See Canada-United States Relations, Vol. II, Canada's Trade Relations with the United States, The Standing Senate Committee on Foreign Affairs (1978) at 87.

56. See E.C. Commission v. Germany, 1975 1 C.M.L.R. 340.

57. Re Importation, note 56 at 717.

58. See Canada-United States Relations, Vol. II, at 87.

59. Ibid. Discussions with External Affairs officers dealing with GATT, and with officers at the US Embassy, pursued through the resources of the Institute of Research on Public Policy, suggest that the Senate Committee statement to the effect that the US government has complained to GATT about bilingual labelling requirements, may be inaccurate. See correspondence with Institute for Research on Public Policy, August 22, 1983.

60. EEC Treaty, art. 36.

61. See "Preamble" and Article 2.1 of the Agreement on Technical Barriers to Trade. See also Article 20 of the GATT "General Agreement on Tariffs and Trade", Basic Instruments and Selected Documents, Vol IV, Text of the General Agreement (1969).

62. See Consumers Association of Canada, Synapse 4 (No. 3 1982); "Sleeper 'Repackaging' Tax irks Marginal Manufacturers", Globe and Mail, 20 March 1981 at B1; Hirschhorn, Product Safety Regulation at 63.

63. Another possible challenge to labelling regulation relates to cost-effectiveness review under a "proportionality" theory of international trade barriers. See Anton Adriaan Fietje (1981), 3 C.M.L.R. 722. It is possible, of course, that selective bilingual labelling regulation may be justified as being the most cost-

effective technique available to Canadian regulatory authorities to achieve health and safety objectives and to protect Canadian consumers against deceptive marketing practices.

64. It is possible but unlikely that a consumer in Canada may be able to recover compensation from a manufacturer based upon express statements contained in informational material distributed by a foreign manufacturer. See Shanklin Piers Ltd. v. Detel Products Ltd., 1951 2 K.B. 854; Murray v. Sperry Rand Corp. (1979), 23 O.R. (2d) 456; Naken v. General Motors of Cda. (1978), 21 O.R. (2d) 780, 92 D.L.R. (3d) 100.

65. These provinces have enacted legislation that permits consumers to sue maufacturers directly, and to recover compensation for personal injury and property damage resulting from a breach of implied contractual obligations relating to product quality. See Consumer Products Warranty Act R.S.S. 1978, c.-30-, s. 11; Consumer Product Warranty and Liability Act, S.N.B. 1978, c. C-18.1 s.12.

66. The Uniform Commercial Code, which is in force in all states but Louisiana, establishes strict liability of manufacturers for breach of implied obligations of quality which result in personal injury or property damage. See Henricus D. Tebbens, International Product Liability, (The Hague: Sijthoff and Noordhoff, 1979) at 20; Uniform Commercial Code, Article 2-318; William Kimble and Robert C. Lesher, Products Liability (St. Paul, Minn.: West Pub. Co., 1979) at 27, 28.

67. California courts were the leading exponents of this development, which is now characteristic of almost all state law. See Greenman v. Yuba Power Prod. Inc., 377 P.2d. 897 (1963); William Lloyd Prosser and John W. Wade, Torts, (Mineola, N.Y.: Foundation Press, 1971) at 654-7; Tebbens, International Product Liability at 22, 23. The vast majority of American states have adopted strict tort product liability doctrines, but even the remaining nine states that require proof of negligence in tort permit strict contractual liability claims against manufacturers. James. E. Beasley, Products Liability and the Unreasonably

Dangerous Requirement (Philadelphia Pa.: American Law Institute-American Bar Association Committee on Continuing Professional Education, 1981) at 309-39.

68. The loss distribution implications of strict products liability have been openly acknowledged by the American judiciary and academics for over a quarter of a century. See J. Trainor in Escola v. Coca Cola Bottling Co., 150 P. 2d. 436 at 441 (1944); G. Calabresi and J.T. Hirschoff, "Toward a Test for Strict Liability in Torts" (1972), 81 Yale L.J. 1055.

69. See Tebbens, International Product Liability at 115.

70. Most parties in the Thalidomide dispute received compensation through extra-judicial settlements. One reported case was S. v. Distillers Co. Biochemicals, [1969] 3 All E.R. 1412; accounts of the dispute can be found in H. Teff, "Products Liability in the Pharmaceutical Industry at Common Law" (1974), 20 McGill L.J. 102; Harvey Teff and Colin R. Munro, Thalidomide: the legal aftermath (Farnborough, Hants.: Saxon House, 1976).

71. McCormack v. Hankscraft Co., 154 N.W.2d. 488 (1967).

72. An excellent discussion of the difficulties a court faces in evaluating the standard expected of deliberate design choice on the part of a manufacturer can be found in Alvin S. Weinstein et al., Products Liability and the Reasonably Safe Product: A guide for management, design, and marketing (New York: Wiley, 1978) at 32-4. A more general discussion of this problem can be found in J.A. Henderson, "Judicial Review of Manufacturers' Conscious Design Choices: The Limits of Adjudication" (1973), 73 Col. L. Rev. 1531.

73. Weinstein et al., Products Liability and Reasonably Safe Product at 29.

74. It can be argued that a third category of defect exists, namely an "information" defect. It is obvious that "defect" is not synonymous with "danger", so that many products that are free of design or manufacturing defects are still capable of injuring users. The concept of an "information" defect originates with the view that while "dangerous" or "hazardous" products may be

unavoidable, accident costs can be reduced if users are informed of risks associated with use or misuse of the product. The courts have imposed this information-disclosure obligation on manufacturers, based on the observation that manufacturers have a more intimate knowledge of their product than do consumers and that consumers are unaware of or unable to perceive dangers associated with certain products. The problem inherent in defining this type of defect is to keep it distinct from the other types of defects. That is, is a design defect of the Thalidomide type not also an information defect? Does user-knowledge of the side-effect remove the defect? If consumers were to be blessed with "perfect knowledge" and thus aware of the use-implications (risks) of the product's design and manufacture, the notion of defect would make little sense.

75. See K. Ross, "Preventing or Limiting Liability Prior to Sale", and R.R. Coulter, "Preventing or Limiting Liability After Sale", in Products Liability of Manufacturers: Prevention and Defence, edited by J.G. Poust and K. Ross, pp. 363-81 (New York: Practising Law Institute, 1977), for a survey of measures available to manufacturers to reduce risk exposure to products liability actions in the United States.

76. Alan A. Shapiro, An Economic Analysis of Consumer Redress Mechanisms, (Ottawa: Consumer Research and Evaluation Branch, CCAC, 1980) at 15. See also, Werner Z. Hirsch, Law and Economics: An Introductory Analysis (New York: Academic Press, 1979) at 132, 133.

77. Hirsch, note 76 at 173.

78. See Jeffrey I. Bernstein and Christopher Green, The Incidence of the Costs of Compliance with Government Regulation, Technical Report No. 1, Regulation Reference, (Ottawa: Economic Council of Canada, 1980) for a discussion of compliance costs associated with regulatory intervention. It is interesting to note that a US National Federation of Independent Business 1976 survey of 1,296 small independent manufacturing firms indicated that one in eight firms did not introduce a new product because

of product liability problems. Paul Halpern and Jack Carr, Liability Rules and Insurance Markets (Ottawa: CCAC, 1981) at 62.

79. It has been argued that American manufacturers can take advantage of savings in production, marketing and insurance costs in relation of exported goods. See R.D. Bishop and P.D. Reynolds, "An Export Primer: Legal Aspects of Exporting from the United States" (1980), 2 Houst. J. Int'l Law 233, at 254.
80. See notes 64-67.
81. See note 65.
82. As noted earlier, it is unlikely that a manufacturer will be found liable under contract law in any event.
83. See Uniform Commercial Code, Article 2-719(3).
84. See Magnuson-Moss Warranty: Federal Trade Commision Improvement Act, 15 U.S.C. 2301 et seq., at s. 2308(a).
85. A comprehensive review of Anglo-Canadian products liability cases uncovers perhaps six reported design defect cases. See D. Cohen, "The Public and Private Law Aspects of the Ureaformaldehyde Problem" Can. Bus. L.J. (forthcoming). As well, it is often conceded that design review is better performed in the regulatory process. See P.S. Atiyah, Accidents, Compensation and the Law (London: Weidenfeld and Nicolson, 1980) at 59-64.
86. See A Proposal for Class Actions under Competition Policy Legislation (Ottawa: Dept. of Consumer and Corporate Affairs, 1976) at 21-27. Recently, the Supreme Court of Canada has applied existing class action rules in a very restrictive fashion. See Naken v. General Motors of Canada (1983), 144 D.L.R. (3d) 385.
87. See P.J. Schlag, "A Critique of the Justification for Employee Suits in Strict Products Liability Against Third Party Manufacturers" (1977), 25 U.C.L.A. L. Rev. 125.
88. W.L.M. Reese, "Choice of Law in Torts and Contracts and Directions for the Future" (1977), 16 Colum. J. of Transnat'l L. 1; E. Scoles, "Interstate and International Distinctions in

Conflict of Laws in the United States" (1966), 54 Cal. L. Rev. 1599; Roy v. Star Chopper Co. 584 F.2d 1124 (1978); J.E. Beasley, Products Liability and the Unreasonably Dangerous Requirement at 695-7. Ontario Law Reform Commission, Report on Products Liability (Toronto: Ministry of the Attorney General, 1979) at 117. Kimble and Lesher, Products Liability at 366. The rationale offered for the application of strict products liability to foreign manufacturers includes the state interest in providing compensation to its citizens, the shifting of accident costs outside the state, and equalization of the competitive position of extra-state and in-state manufacturers. See Note, "Products Liability and the Choice of Law" (1965), 78 Harv. L. Rev. 1452, at 1464. It is unlikely, except in Saskatchewan and New Brunswick, that Canadian courts would adopt an equivalent distinction between local and out-of-province manufacturers. See Consumer Product Warranties Act, 1970 at s. 33(i); Consumer Product Warranty and Liability Act, 1978 at s. 27(i). Even where Canadian courts take jurisdiction over an American manufacturer (which, it seems they will: Moran v. Pyle Nat'l (Cda.) Ltd., [1975] 1 S.C.R. 393; Ontario Law Reform Commission, Report on Products Liability at 108-10), the American manufacturer will be able to rely on the lower "negligence" standard applied in most Canadian provinces. See Ontario Law Reform Commission, Report on Products Liability at 113, 115. Robert J. Sharpe, Interprovincial Product Liability Litigation: Jurisdiction, Enforcement and Choice of Law, (Ottawa: Consumer Research and Evaluation Branch, CCAC, 1981) at 133-4.

89. See Oswalt v. Scripto Inc., 616 F.wd. 191 (1980); Scanlan v. Norma Projektil Frabrik, 345 F.Supp. 292 (1972); Blum v. Kawaguchi Ltd., 331 F. Supp. 216 (1971). The courts acknowledge a "relaxed jurisdicational standard" applied to alien manufacturers. See Poyner v. Erma Werke GmbH, 618 F.2d. 1186, at 1192 (1980), cert. denied 449 US 841; Note, (1981), 4 J. of Int'l Law and Bus. 323; K. Maerowitz, "World-Wide

Volkswagon Corp. V. Woodson: A Limit to the Expansion of Long-Arm Jurisdiction" (1981), 69 Calif. L. Rev. 611. Concerns have been expressed that such discriminatory standards will deter alien manufacturers from exporting to the United States. See Note (1982), 4 J. of Int'l L. of Bus. 323 at 346, 349; Note, "Developments in the Law-State Court Jurisdiction" (1968), 73 Harv. L. Rev. 909, at 987. As well, several commentators have suggested that alien defendants' contact with the United States will be assessed on a national rather than on a state basis for the purposes of state court jurisdiction. Note, B.B. Frasch, "National Contacts as a Basis for In Personam Jurisdiction Over Aliens in Federal Question Suits" (1982), 70 Calif. L. Rev. 686; G.C. Lilly, "Jurisdication over Domestic and Alien Defendants" (1983), 69 Virg. L. Rev. 85, at 124-9.

90. US jury awards for pain and suffering are potentially much greater than Canadian awards. While Canadian courts have established a policy to limit pain and suffering awards, little of the same has been done in the United States. See Ontario Law Reform Commission, Report on Products Liability at 75. Halpern and Carr, Liability Rules and Insurance Markets at 73, report that the state of Illinois has limited pain and suffering awards to $500,000, five times higher than the limit suggested by the Supreme Court of Canada in Andrews v. Grand and Toy Alberta Ltd. (1978), 83 D.L.R. (3d) 452.

91. See D. Owen, "Problems in Assessing Punitive Damages Against Manufacturers of Defective Products" (1982), 49 U. of Chi. L. Rev. 1; D. Owen, "Punitive Damages in Products Liability Litigation" (1976), 78 Mich. L. Rev. 1257; Grimshaw v. Ford Motor Company, 174 Calif. Reptr. 348 (1981); Rinker v. Ford Motor Company, 567 S.W.2d. 655 (1978). Compare Allen M. Linden, Canadian Tort Law (Toronto: Butterworths, 1982) at 51-55; Robitaille v. Vancouver Hockey Club Ltd. (1981), 16 C.C.L.T. 225 (B.C.C.A.).

92. See Gordon Associates, (Interagency Task Force on Product Liability) Product Liability: Final Report of the Industry Study,

Vol. I, (Springfield VA.: US Dept. of Commerce, National Technical Information Service, 1977); "Products Liability: The Impact on California Manufacturers" (1981), 19 Am. Bus. L.J. 343, at 346-7 and 356-8. Contractual risks borne by manufacturers under state law may impose differential costs and risks on smaller firms. See W.H. Lawrence and J.H. Minan, "The Role of Warranties and Product Standards in Solor Energy Development" (1981), 34 Vand L. Rev. 537, at 547-8 and 568. It seems fair to say the Canadian manufacturing enterprises, even if restricted to exporting firms, are smaller than their American counterparts. Globerman, U.S. Ownership of Firms in Canada at 69, 89-90.

93. See Firsch v. Int'l Harvester Co., 338 N.E.2d. 90 (1975); Kerns v. Engelke, 369 N.E.2d. 1284 (1977).

94. Empirical evidence suggests that, for many reasons, perhaps including awareness of the availability of legal redress mechanisms, Canadian consumers are much less likely to pursue product liability suits than US consumers. See Stephen B. Ash, Consumer Satisfaction and Complaining Behaviour. Major Findings and Directions for Action, (Ottawa: CCAC. 1980); Atiyah, Accidents, Compensation and the Law at 235-244.

95. This does not mean that Canadian consumers do not enjoy the benefit of effective deterence, except in instances where substandard or defective products are deliberately exported. Canadian plaintiffs have access to the American judicial system even though the expense of litigating in the United States is likely to be considerably greater than litigation in Canada. This does not, however, remove the disincentive involved in such litigation, and thus both Canadian and U.S. consumers may be paying for insurance coverage they will not benefit from.

96. Black and Decker Canada Inc., having decided that it needed access to the American market to justify development of its "Workmate", was met with recommended design changes from its major potential customer relating to the risk of "catastrophic failure" resulting from product misuse. See, "Case I, Black and

Decker Canada Inc., (B) Workmate", in Dhawan et al., International Business at 854-5.

97. See General Agreement on Tariffs and Trade, Basic Instruments and Selected Documents, Volume IV, Text of the General Agreement (Geneva: GATT, 1969), article I, article III.1, article III.2, article X.3(a), article XI.1, and article XX.

98. See P. Oliver, Free Movement of Goods at 128; Italy v. E.E.C., 1963 C.M.L.R. 289; Rewe-Zentralfinanz v. Direktor der Landwirtschafskammer, 1977 1 C.M.L.R. 599.

99. As noted in Minutes of Proceedings and Evidence of the Standing Committee on Finance, Trade and Economic Affairs, 17 February 1981, Vol. 38 at 5, 9.

100. Statistics indicate that while only 45 per cent of toys in Canada are imports, 80 per cent of non-complying products under the Hazardous Products Act R.S.C. 1970, c. H-3 were imported. Hirshhorn, at 77-89.

101. Hirshhorn, Product Safety Regulation at 112.

102. Marks and Malmgren, "Negotiating Non-Tariff Distortions" at 395, 396; Textile and Apparel Group v. F.T.C., 410 F.2d. 1052, at 1054 (1969).

103. See note 92. See also M. Dewis, D.C. Hutchins and P. Madge, Product Liability (1980) at 87; Pestieau and Henry, "Non-Tariff Trade Barriers" at 60-70; I. Walters, "Non-Tariff Barriers and the Export Performance and Developing Economies" (1971), Am. Econ. Rev. 195-205.

104. Peterson and Peterson Impact of Economic Regulation at 5, 19; Economic Council of Canada, Reforming Regulation (Ottawa: The Council, 1981) at 126; Need for Economic Information on Standards Used in Regulatory Programs: Problems and Recommendations, (Washington: US Dept. of Commerce, National Bureau of Standards, 1980) at 15.

105. Final Report of the Interagency Task Force on Product Liability (1977) Ch. 3 at III-2-4.

106. "Regulating Chrysler out of Business", Regulation (Sept/Oct. 1979): 46.

107. Lecraw, Voluntary Standards at 87.

108. Lawrence and Minan, "Role of Warranties and Product Standards" at 596.

109. P. Linneman, "The Effects of Consumer Safety Standards: The 1973 Mattess Flammibility Standard" (1980), 23 J. of L. & Econ. 461, at 473-7.

110. William H. Lawrence and John H. Minan, "The Limited Role of Warranties" in Legal Aspects of Solar Energy, edited by W.H. Lawrence and J.H. Minan, pp. 179-195, (Toronto: Lexington Books, 1981) at 182.

111. John W. Evans, The Kennedy Round in American Trade Policy (Cambridge, Mass.: Harvard University Press, 1971); Note, "The Restrictive Effects of Industrial Standards on International Commerce" (1972), 4 L. and Pol. in Int'l Bus. 607, at 609-10; Sweeney, "Technical Analysis" at 183.

112. Groetzinger, "New GATT Code" at 171-2.

113. Ibid. at 173-4.

114. For a detailed account of this international participation see The Canadian Contribution to International Standards: How Canada Participates in the Work of International Standarization Organizations, (Ottawa: Standards Council of Canada, 1981). The ISO and IEC are the two principal non-governmental standardization organizations affecting international trade. Their combined activities encompass all standards topics. Although the IEC is an older organization, the scope of ISO activity is much broader and thus not surprisingly, it has wider participation. The IEC is confined to matters concerning the electrotechnical field and has some 42 national committees. The ISO deals with all topics outside of the electrotechnical field and is comprised of some 86 national standardizing bodies. Until 1972, the ISO's work was limited to recommendations "that would be used as background documents for the national standards, 'the real standards' . . .from 1972, however the ISO results have been published as 'International Standards'. . .to be used directly, in their own right, at all levels and everywhere."

Olle Sturen, Responding to the Challenge of the GATT Standards Code (Geneva: ISO, March 1980) at 6.

115. The National Standards System of Canada: The Second Five Years 1976-80 (Ottawa: Standards Council of Canada, 1976) at 21; Standards Council of Canada, Canada's National Standards System, Part I at iii.

116. See National Standards System: Criteria and Procedures for Accreditation of Certification Organizations, (Ottawa: Standards Council of Canada, 1981). Standard Writing Organizations which have been accredited include Warnock Hersey Professional Services Ltd, Underwriters' Laboratories of Canada, Canadian Standards Association, Canadian General Standards Board, and the Canadian Gas Association.

117. Can-P-1005A, Harmonization of Canadian National and Canadian International Standards Work and Management of Committees Involved in Harmonized Work, (Ottawa: Standards Council of Canada, 1980) at 1.

118. Standards Council of Canada, Annual Report 1980-81, 8 June 1981 at 3. Discussions with Standards Council Officials through offices of Institute for Research on Public Policy, August 1983.

119. It appears that European countries, particularly France, have more readily adopted ISO standards than have Canada or the United States. One explanation given for this is that Europeans have been more actively involved in the ISO than have either Canada or the United States and that European involvement has been through government funded and/or operated national standards organizations. American involvement has been through ANSI which is neither funded nor officially connected to any level of government. Similarly, Canadian involvement has until recently been through an independent standard writing organization. See Groetzinger, "New GATT Code" at 176-7. Nonetheless, the Standards Council has adopted measures designed to facilitate international harmonization in the Canadian standards setting process. See (Standards Council of Canada) National Standards System: Criteria and Procedures,

Annex A "Assessment of Draft I.S.O. and I.E.C. Standards for Implementation of Canadian Standards". See also para. 9.3 in that work.

120. GATT, Agreement on Technical Barriers to Trade, article 2.2.

121. See notes 45 and 55. In addition to labelling legislation, a collection of non-tariff standard barriers is contained in GATT, "Multilateral Trade Negotiations", Part 3 of the Non-Tariff Measures. Additional examples include, the inability of American manufacturers of child automobile-restraint systems to export to Canada in the face of stringent Canadian regulations (see Shaul and Trebilcock, "Administration of Federal Hazardous Products Act" at 27; Hirshhorn, Product Safety Regulation at 92, 95); the exclusion of lower quality structural steel manufacturers (see Lecraw, Voluntary Standards at 75, and Appendix A at 14); and volume and size regulations applied to metallic cans (see Michael J. Trebilcock et al., The Choice of Governing Instruments: Some Applications, A Study prepared for the Economic Council of Canada, Tech. Rep. No. 12, Regulation Reference, (Ottawa: Economic Council of Canada, 1981) at V-10. The standards barrier may be established by provincial product safety regulation as well. See "U.S. Company altering artificial milk formula", Globe and Mail, 9 August 1983 at 4.

122. For example, the primary national standards document in Canada, the National Building Code, lists 183 standards of which 18 per cent are direct references to standards established by US standards bodies. See the Supplement to the National Building Code of Canada, issued by the Associate Committee on the National Building Code, (Ottawa: National Research Council, 1980). The degree of uniformity is revealed by the redesignation of US standards from "American Standards" to "American National Standards" in order to distinguish the US standard from those adopted in the "North American" market. See Robert F. Leggett, Standards in Canada (Ottawa: Information Canada, 1970) at 130-2; M. Dewis, D.C. Hutchins and P. Madge, Product Liability (1980) at 30. A specific example

of this standard setting co-ordination was the American and Canadian ban of DES hormone growth stimulants within three months of one another (Marks and Malmgren, "Negotiating Non-Tariff Distortions" at 393). The response by Canadian authorities has been described by American commentators as a disguised trade restriction, rather than as an example of international co-operation on carcinogenic risks posed by pharmaceutical products. See R.E. Hudec, "Retaliation Against 'Unreasonable' Foreign Trade Practices: The New Section 301 and GATT Nullification and Impariment" (1975), 59 Min. L. Rev. 461, at 535. Enforcement policy may also be well-coordinated between the two jurisdictions. See "GM is in the hotseat", Vancouver Province, 5 August 1983 at 13.

123. Hemenway, Standards Systems in Canada, the U.K., West Germany and Denmark, at 3.

124. Ibid. at ix; Lecraw, Voluntary Standards; Preston, P. and Associates, Directory of Standards Referenced in Canadian Federal Legislation, prepared for the Standards Council of Canada, CAN-SP 3 (Ottawa: SCC, 1979) as amended.

125. See Shaul and Trebilcock, "Administration of Federal Hazardous Products Act" at 11, 13; Consensus, 10 (No. 1 1983) at 8; Michel Proulx and André Morin, A Case Study: Proposed School Bus Safety Standards under the Canadian Motor Vehcile Act, (Ottawa: CCAC, Supply and Services Canada, 1978) at 6, 10.

126. Shaul and Trebilcock, "Administration of Federal Hazardous Products Act" at 24, 25; See also, Proulx and Morin, A Case Study at 5.

127. See National Bureau of Standards, Performance Concept in Buildings, NBS Special Publication 361, (Washington: US Dept. of Commerce, National Bureau of Standards, 1972).

128. Hirshhorn, Product Safety Regulation at 66.

129. See Marks and Malmgren, "Negotiating Non-Tariff Distortions" at 393; Jess & Clark Inc. v. F.D.A., 495 F.2d. 975; Hirshhorn, Product Safety Regulations at 68, note 34.

130. See "U.S. market still key to Canadian design", Globe and Mail, 8 March 1982 at B6; "C.S.A. to set standards in telecommunications", Globe and Mail, 27 January 1983 at B13.

131. See examples cited in Lecraw, Voluntary Standards, Appendix A, at 3, 8, 20 and 37; Proulx and Morin, A Case Study at 11, at note 28.

132. Hirshhorn, Product Safety Regulation at 68; Proulx and Morin, A Case Study at 11.

133. "U.S. Market still key to Canadian design", Globe and Mail, 8 March 1982 at B6; Globerman, U.S. Ownership of Firms in Canada, at 10-13, 45; The Annual Review of the Economic Council of Canada, (1978) at 27-30.

134. Leggett, Standards in Canada at 125, 208, No. 1 at 8; Lecraw, Voluntary Standards, at Appendix A. See, for example, "Anesthetic associated with 16 deaths", Vancouver Sun, 25 August 1983 at F10, describing the cooperation between the American Food and Drug Administration and the Canadian Department of National Health and Welfare. More recently the North American Presentation Level Protocol Syntax (NAPLPS)--a standard for creating and transmitting colour graphics--was negotiated among the Canadian Standards Association and the American National Standard for Information Interchange and both American and Canadian systems manufacturers. See "NAPLPS Emerges from Pact as New Standard", Globe and Mail, 1 July 1983 at p. B10.

135. See Consensus, 7 (No. 4 1980) at 9 (ASTM Committee on Prosthetics and Orthotics); Leggett, Standards in Canada at 125; Consensus, 9 (No. 2 1982).

136. Slot, Technical and Administrative Obstacles at 152.

137. See notes 149, 150.

138. Middleton, "GATT Standards Code" at 202.

139. See Agreement on Technical Barriers to Trade, article 2.2

140. See Hemenway, Standards System in Canada, the U.K., West Germany, and Denmark, at 3; Fred O'Riordan and Lee McCabe, A Case Study: Safety Glass Regulations Under the Hazardous

Products Act, (Ottawa: Supply and Services Canada, 1980) at note 17. Lecraw, Voluntary Standards at 80, and at Appendix A at 15.

141. See Hirshhorn, Product Safety Regulation at 97.

142. A description of ISO and IEC activities is contained in Leggett, Standards in Canada. See also Groetzinger, "New GATT Code" at 174-176. Middleton, "Standardization and International Economic Cooperation", 7 J.W.T.L. 500, at 506 and 507.

143. Groetzinger, "New GATT Code" at 176.

144. See Consensus, 9 (No. 3 1982) at 4 and 9; Olle Sturen, "Developments in International Standardization and Their Relevance to Foreign Trade", Consensus, 9 (No. 2 1982) at 4; Middleton, "Standardization" at 509.

145. Olle Sturen, Secretary General of ISO, "Responding to the Challenge of the GATT Standards Code" (1980) at 4.

146. See examples cited at note 157. Consensus, 7 (No. 4 1980) at 4.

147. American National Standards Institute (ANSI), Voluntary (Private Sector) Standard Programs and the GATT Code (1978) at 10.

148. Ibid., at 8. Unlike Japan and Germany the United States has adopted a deliberate "standard export" policy. See Sturen, "Developments in International Standardization" at 6-15; MTN Studies, "Agreements Being Negotiated" at 45, 163, 177-8. It is true that Canada is also seeking to export its standards, but one must question whether developing nations will choose Canadian standards (and technology) in light of the extent of Canadian manufactured goods exports. Canada, the United States, France, Japan, and Germany have, to varying degrees, established programs designed to export their respective standards, and certification procedures through technical assistance and educational programs. See, for example, Standards Council of Canada, Highlights of the Annual Report, 1981-82 (Ottawa: SCC, 1982) at 5; GATT, Committee on Technical Barriers to Trade, First Annual Review of the Operations of the Agreement (Geneva: GATT 1981) at 50, 51; Lecraw, Voluntary Standards at 25, 91, 97; Leggett, Standards in Canada at 216, 222; Standards

Council of Canada, Annual Report (1980-81) at 6; The Canadian Contribution to International Standards (Ottawa: SCC, 1981) at 5. However, it appears that while Japan has generally produced products which meet its importing countries standards, and while Britain has adopted international standards as national standards, the United States has generally attempted to persuade or influence its markets to adopt US standards.

149. Sturen, "Developments in International Standardization" at 4; in the MTN Studies, "Agreements Being Negotiated" at 15 it was pointed out that the major impetus for US involvement in the GATT Standards Code was to gain access to European markets.

150. Correspondence with officials at the Institute for Research on Public Policy, 22 August 1983. Report by Canadian Government, Multilateral Trade Negotiations 1979: Canadian Participation, (Ottawa: Supply and Services Canada, 1979), at 109.

151. Sturen, "Responding to the Challenge" at 1; Bernier, "Product Standards and Non-Tariff Obstacles" at 206.

152. It is generally acknowledged that many developing countries, as representatives of product users, do not have the financial resources or expertise to participate effectively in ISO activities. Consensus 9 (No. 4 1982) at 9-10, 13. Some developed nations have gone so far as to advocate "weighted" voting for ISO members depending on financial contribution to ISO. Consensus, 8 (No. 4 1981). In 1981, it was reported that standard bodies from France, Germany, Japan, the U.K. and the United States were responsible for more than 85 per cent of ISO activity of significance to international trade; and the American representative (ANSI) participated in 98 per cent of ISO technical committees. ANSI, Voluntary (Private Sector) Standards Programs at 10.

153. See note 156. The ISO has studied this issue and has responded by adopting several procedural reforms. It is too early to assess the impact of those steps. See Standards Council of Canada, Annual Report (1980-81) at 3.

154. Thus concern has been expressed that adoption of ISO standards may expose domestic workers to increased health risks. Sweeney, "Technical Analysis" at 169.

155. T. Gregory Kane, Consumers and the Regulators: Intervention in the Federal Regulatory Process, (Montreal: IRPP, 1980) at 22-7 and at 99-101; Kenneth G. Englehart and Michael Trebilcock, Public Participation in the Regulatory Process: The Issue of Funding, Working Paper No. 17, Regulation Reference, (Ottawa: Economic Council of Canada, 1981) at 18-24.

156. Ibid. See also Shaul and Trebilcock, "Administration of the Federal Hazardous Products Act" at 36, 37.

157. John Kolb and Steven S. Ross, Product Safety and Liability: A Disk Reference, (New York: McGraw-Hill, 1980) at 20, 52. See also Shaul and Trebilcock, "Administration of the Federal Hazardous Products Act" at 29. While many ISO representations are "governmental", the ANSI is entirely private, and the private sector provides advisors to governmental delegates. See ANSI, Voluntary (Private Sector) Standard Programs at 6. A comprehensive study of standard setting in Canada suggested that the fact that ANSI is a "private enterprise" has given rise to problems "not difficult to imagine". See Leggett, Standards in Canada at 220. Groetzinger has made the same point in "New GATT Code" at 176. As well, it may be that only the more powerful commercial interests have the necessary influence and resources to influence standard setting. See Peterson and Peterson, Impact of Economic Regulation and Paperwork at 23.

158. See Hirshhorn, Product Safety Regulation at 110. There is some evidence that the attitude of the Department of Consumer and Corporate Affairs towards international trade are "anti-protectionist" and pro-trade, suggesting that this "safety-imperative" may be attenuated in a review of ISO standards should it take place. See David Protheroe, Imports and Politics: Trade Decision-Making in Canada, 1968-1979, (Montreal: IRPP, 1980) at 86-8.

159. Middeton, "Standardization" at 509; Kolb and Ross, *Product Safety and Liability* at 169; *Consensus* 8 (No. 4 1981) at 10.
160. *Consensus*, 9 (No. 3 1982) at 3.
161. See *R. v. Ciarniello* (1979), 12 B.C.L.R. 394; *R. v. Horbacks* (1968), 65 W.W.R. 129; *R v. Joy Oil Co.*, 1963 3 C.C.C. 260; *Township of Madoc v. Quinlan* (1971), 3 O.R. 540; Lecraw, *Voluntary Standards* at 39-42; L.L. Jaffe, "Law Making by Private Groups" (1937), 51 *Harv. L. Rev.* 201, at 236.
162. It is quite possible that subsidiary federal legislation must be enacted in both official languagues.
163. *Need for Economic Information on Standards Used in Regulatory Programs, Problems and Recommendations* (Washington: U.S. Dept. of Commerce, National Bureau of Standards, 1980) at 4-8. Of special concern to government is the fact that voluntary consensus standards often do not take into account enforcement costs. *Ibid.*, at 29, 30.
164. See Treasury Board of Canada, "Socio-economic Impact Analysis", *Administrative Policy Manual*, Chapter 490 (1979).
165. N.J. Byrne, "Dismantling the Technical Barriers to Inter-Community Trade" (October 1979), *New L. J.* 999, at 1000-01, discussing the *Re Agreements on Video Cassette Recorders*, 1978 2 C.M.L.R. 160; Europa Institute of the University of Leiden, ed., *European Competition Policy: Leiden Working Group on Cartel Problems*, (Leiden: Sijthoff, 1973) at 37, 38; *The Community v. Association Nationale des Services D'Eau (Anseau-Narewa)*, 1982 2 C.M.L.R. 193; Lecraw, *Voluntary Standards* at 34; Legett, *Standards in Canada* at 186.
166. Byrne, "Dismantling the Technical Barriers" at 999; Lecraw, *Voluntary Standards* at 78; James P. Cunningham, *The Competition Law of the E.E.C.: A Practical Guide*, Supplement, (London: Kogan Page, 1975) at 191.
167. See Bernier, "Product Standards and Non-Tariff Obstacles" at 195-198, 217.
168. See D. Bazelon, *Science* 205 (No. 4402 1979): 277; Science Council of Canada, *Regulating the Regulators, Science, Values*

and Decisions, (Ottawa: SCC, 1982) at 11, 70.

169. See Agreement on Technical Barriers to Trade, article 2.2 and Preamble at para. 6; Bernier, "Product Standards and Non-Tariff Obstacles" at 198. The point has been made that the equivalent EEC Treaty of Rome provision has been a prolific source of litigation. Stuart, Lord Mackenzie, The Freedom of Movement of Goods (1979) at 10.

170. See Minutes of Proceedings and Evidence of the Standing Committee on Finance, Trade and Economic Affairs, 17 February 1981, Vol. 38 at 7.

171. Laurence H. Tribe, American Constitutional Law (Mineola, N.Y.: Foundation Press, 1978) at 323, 324.

172. This view is analogous to the doctrine developed in the United States in dealing with the trade barriers at the state/federal level. See Southern Pac. Co. v. Arizona 325 U.S. 761, at 770-771 (1945); Cooley v. Board of Wardens, 53 U.S. 299 (1851); Tribe, American Constitutional Law at 325.

173. European Economic Community, Treaty of Rome, Cmmd 5179-II, article 30 and article 36.

174. See R. v. Goldstein (1982), 1 W.L.R. 804, at 808-809 (C.A.); Re Restrictions on Importation of Souvenirs: E.C. Comm'n v. Ireland, 1982 1 C.M.L.R. 706. See also, Agreement on Technical Barriers to Trade. It is important to note that permissible objects under the Standards Code are restricted to health, safety and fairness measures, and do not extend to "public policy" measures. Bilingual labelling would not, it seems, be permissible if justified as a measure to achieve "national unity". See Report of the Standing Senate Committee on Foreign Affairs, Canada-U.S. Relations, Canada's Trade Relations with the United States Vol. II (1978). It may be possible to argue that specific bilingual labelling requirements are necessary for the prevention of deceptive trade practices, and to reduce product safety risks. See note 63. Recently, France has rescinded its French language rules requiring all import documents to be translated into French. Apparently this

move was taken in response to threatened actions by the European Commission under the Treaty of Rome. See Common Market Reports, Euromarket News, Issue No. 747, Report No. 474, 11 May 1983 at 3.

175. Agreement on Technical Barriers to Trade, Preamble and article 2.2.

176. See R. v. Goldstein, 1983 1 C.M.L.R. 244, at 249 (1982); Rewe-Zentral A.G. v. Bundesmonopolverwaltung für Branntwein, 1979 3 C.M.L.R. 494; Officier van Justitie v. Eyssen B.V., 1982 2 C.M.L.R. 20; Current Survey (1983), 8 European L. Rev. 118, at 119-22. While "proportionality" is an explicit requirement under the Treaty of Rome, it would seem that a similar analysis of the Standards Code is appropriate. The preamble of the code recognizes that countries must be permitted to establish measures necessary to protect, interalia, human, animal or plant life or health, and that even such necessary measures must be justified if discriminatory. Article 2.2 of the Code, which establishes the general harmonization principle, exempts only domestic harmonization where it is inappropriate for the protection of human health or safety. Section 401 of the United States Trade Agreement Act (19 U.S.C. 2531), which establishes the American implementation program for the Standards Code, supports the view that impermissable obstacles to trade should be defined in this manner. See Sweeney, "Technical Analysis" at 194.

177. See Officier Van Justitie v. de Peijper, [1976] 2 C.M.L.R. 271.

178. See Tribe, American Constitutional Law at 329, 340; American Can. Co. v. Oregon Liquor Control Comm'n, 517 P. 2d. 691, at 697 (1974); B. of Locomotive Fireman v. Chicago R.I. & R.R. Co., 393 US 129 (1968).

179. Oliver, Free Movement of Goods at 139; L. Cathpole and A. Barav, "The Public Morality Exemption of the Free Movement of Goods. Justification of a Dual Standard in National Legislation", Leg. Iss. of Eur. Integration 1 (1980/81) at 15.

180. See R. Plender and J. Usher, Cases and Materials on the Law of the European Communities (1980) at 323-326; Oliver, Free Movement of Goods at 130, 131; Officier Van Justitie v. de Peijper, 1976 2 C.M.L.R. 271.

181. See "Walker Milks the British Consumers yet again", The Economist, 12 February 1983, at 49-50. A similar result has been achieved in the United States where state regulatory measures have been disallowed where reasonable non-discriminatory alternatives are adequate to achieve legitimate local interests. See Dean Milk Co. v. City of Madison 340 U.S. 349 (1951).

182. See for example, 19 U.S.C.A. 2531-2533 (West Supp. 1979). As noted earlier, the Code does not appear to interfere with domestic consumer safety objectives, but rather with the means necessary to achieve them. But see R.J. Zedalis, "Legal Effect of the Multilateral Trade Negotiations: Agricultural Commodities" (1980), Den. J. Int'l L. & Pol. 89, at 94 and 98, who argues that the Code's requirement that only "legitimate" health and safety interests may be served, may result in review of the degree of health and safety which the measures are designed to achieve.

183. See Treasury Board of Canada, "Socio-economic Impact Analysis". Presently, there is no legal requirement to carry out either cost-benefit or cost-effectiveness analysis on proposed regulations, and it appears that "intuition" may replace analysis in many instances. See Hirshhorn, Product Safety Regulation at 42.

184. Thus the European Court of Justice has suggested that product bans are not permissible where ingredient labelling provides consumers with information that will preclude confusion. See Rewe-Zentral A.G. v. Bundesmonopolverwaltung für Branntwein, 1979 3 C.M.L.R. 494; Italian State v. Gilli and Andres, 1981 1 C.M.L.R. 146, at 154. As well, labelling legislation will be prohibited where the labelling standards of the exporting state already provide the requisite information.

Robertson et al., [1983] 1 C.M.L.R. 556, at 569.

185. Priest, "Provision of Information in the Context of Regulation", Technical Report No. 22, Regulation Reference, (Ottawa: Economic Council of Canada, 1982) at note 22. See also A. Blair, "Prospects for Implementation of the GATT Standards Agreement in the United States" (1980), 20 Virg. J. Int'l L. 699, at 719.

186. Agreement on Technical Barriers to Trade, article 2.4. Admittedly, this preferential bias in favour of performance standards is qualified by article 2.4, which provides that "whenever appropriate, parties shall specify technical regulations and standards in terms of performance rather than design or descriptive characteristics". A design specification requires that products be made up of specific components or materials, be of a specific shape, size, or perhaps possess certain physical characteristics. A performance standard is written in terms of functional requirements and often consists of both the functional or performance criteria and a method of determining if the standard has been met. See D. Hemenway, Performance vs Design Standards, (Washington, D.C.: National Bureau of Standards, 1980) at 1.

187. Thus the Treasury Board directive establishing mandatory socio-economic impact analysis provides for a presumption in favour of performance standards. See note 164. These benefits involve the encouragement of innovation, the denial of protection to existing firms, a reduction in the anti-competitive characteristics of standards, a reduction in trade barriers, and the promotion of internal efficiency in meeting the standards. See Hemenway, Performance vs Design Standards at 22, 23; MTN Studies, "Agreements Being Negotiated" at 165; Kolb and Ross, Product Safety and Liability at 57.

188. There is some evidence that the Product Safety Branch in the Department of Consumer and Corporate Affairs prefers performance standards in order to reduce the risk that suppliers circumvent standards though the development of close

substitutes; see Shaul and Trebilcock, "Administration of Federal Hazardous Products Act" at 25. Apparently, United States government agencies have adopted a similar policy. See Hemenway, Performance vs Design Standards at 5.

189. Hemenway, Performance vs Design Standards at 5, 11, 29.

190. Richard, Nelson et al., Technology, Economic Growth and Public Policy (Washington, D.C.: Brookings Institute 1967) at 201.

191. Hemenway, Performance vs Design Standards at 5-7. Test methods may introduce additional costs relating to uncertainty, testing expenses, and delays. See also Hirshhorn, Product Safety Regulation at 112.

192. Ibid., at 7, 8.

193. Ibid., at 9.

194. See Agreement on Technical Barriers to Trade, article 2.5. GATT, Committee on Technical Barriers to Trade, 19 June 1980, Minutes, at Annex I. See also, Standards Council of Canada, Criteria and Procedures for the Preparation and Approval of National Standards of Canada, Highlights from the Annual Report, 1981-82, (Ottawa: SCC, 1982) at 1. It is not clear that the dozen sources of information on the development of governmental standards in Canada, will be accessible to foreign firms and states. See GATT, Committee on Technical Barriers to Trade, First Annual Review of the Agreement, at 59, 60. Search costs associated with international standards have been reduced throught the establishment of national "enquiry points" under article 10 of the Standards Code. See, Standards Council of Canada, Press Release, 1981-03-25. O. Sturen, "Responding to the Challenge" at 9.

195. Charles Pearson, "Environment and International Economic Policy" in Environment and Trade: The Relation of International Trade and Environmental Policy, edited by Seymour J. Rubin and Thomas R. Graham, pp. 46-63, (Totowa, N.J.: Allanheld, Osmun, 1982), at 54.

196. Rubin and Graham, Environment and Trade at 162-3. Some commentators have made the point that transparency and

comment procedures are insignificant in comparison with international certification programs. See "Trade Barriers, A France-German Impasse", The Economist, 25 June 1983, p. 54.

197. Blair, "Prospects for Implementation" at 704.

198. See Minutes and Proceedings of the Standing Committee on Finance, Trade and Economic Affairs, Vol. 39, 26 February 1981 at 8.

199. Slot, "Technical and Administrative Obstacles" at 159.

200. See R.W. Hamilton, "Prospects for the Nongovernmental Development of Regulatory Standards" (1983), 32 Am. U. L. Rev. 455, at 462-3.

201. Ibid., See also Leggett, Standards in Canada at 126-7.

202. Slot, "Technical and Administrative Obstacles" at 56.

6: CANADA AND INTERNATIONAL REGULATION OF PRIMARY COMMODITY MARKETS: THE CASE OF MINERALS

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CANADA AND INTERNATIONAL REGULATION OF PRIMARY COMMODITY MARKETS: THE CASE OF MINERALS

Introduction

Proposals for inter-governmental collaboration to influence primary commodity markets have demanded an unprecedented amount of attention from Canadian government officials and businessmen in recent years. Since the 1950s, developing countries have been calling for inter-governmental regulation of primary commodity markets to overcome the problems of commodity price instability and declining terms of trade. However, it was only in the wake of the OPEC-inspired oil price increases of 1973-74 that the less-developed countries (LDCs) succeeded in forcing commodity issues to the top of the international diplomatic agenda and were able to force the governments of developed countries, including Canada, to focus attention on the issue of market regulation for those commodities exported by developing countries. This international diplomatic pressure on the Canadian government has been matched. In the case of a small number of the primary commodities exported by Canada, by pressure from some Canadian producers and their employees. These groups are seeking government action to deal with what they have perceived to be unsatisfactory levels of prices, earnings, and employment.

Canada has found itself in an ambiguous position when negotiating the inter-governmental regulation of primary commodity markets. Most of these negotiations since the 1960s have been set in a North-South context, with developing commodity exporting countries pitted against developed commodity importing countries. Canada's problem is that it does not fit comfortably into either category.

Primary commodities account for a larger proportion of Canadian exports and of overall economic activity in Canada than is the norm among the northern industrialized countries. In 1979, exports of all primary commodities (excluding fuels) accounted for 31.2 per cent of Canadian export earnings, compared to 17.1 per cent for the western industrialized countries as a whole. In fact, the share of Canada's total export earnings accounted for by non-fuel primary commodities more closely approximated the figure for the non-oil exporting developing countries (39.5 per cent) than it did the one for the western industrialized countries.[1]

Canada runs a consistently large surplus in its primary commodity trade account, which does help to offset chronic deficits in other balance-of-payments accounts. For example, 1979 exports of non-fuel minerals up to the refined metal stage were valued at $11.1 billion, as compared to imports in the same category of $5.1 billion and total imports of $62.9 billion.[2] However Canadian primary commodity production, like that in most developing countries, is highly dependent on foreign markets; in 1980, approximately 80 per cent (by value) of non-fuel mineral production was exported.[3] Also like many developing countries, Canada depends to a considerable degree on foreign capital for the development of its resources and views the upgrading of those resources prior to export as an important stimulus to industrialization.[4] Many observers have concluded from these characteristics of the Canadian economy that Canada shares an interest with developing countries in inter-governmental regulation of primary commodity markets.[5]

However, in other respects, Canada has a great deal in common with the western industrialized countries. Canada is a wealthy country, and its economy is much more diversified and industrialized than are the economies of most commodity exporting developing countries. Canada's links with other western countries are much stronger and more varied than are its links with developing countries. Finally, Canada is a significant importer of a number of primary commodities exported by developing countries.[6]

Even in the area of primary commodity exports, Canada's experience has differed significantly from that of the developing countries. Canada did not suffer from a secular deterioration in its terms of trade from the early 1950s to the early 1970s, as did many developing countries dependent on the export of primary commodities, because Canada exported a wide enough variety of manufactured goods and primary commodities to permit deteriorating terms of trade in some sectors to be offset by improving terms of trade in others.[7] Furthermore, the diversity of Canadian exports among many primary commodities and manufactured goods has protected Canada from the destabilizing impact that fluctuations in export earnings from one commodity can have on the aggregate export earnings of less diversified economies. Thus, while producers of particular commodities and the regions in which they are concentrated have suffered from both declining prices and unstable earnings, there has been no general concern in Canada with these two major problems, which developing countries have sought to correct through intergovernmental regulation.[8]

Minerals have traditionally made an important contribution to Canadian economic development, and the federal and provincial governments have traditionally viewed mineral resources as a basis upon which to build a more diversified and industrialized economy in Canada. The primary thrust of Canadian mineral policy has therefore been to upgrade minerals prior to export by encouraging increased mineral processing and mineral-based manufacturing in Canada. This would increase the value of Canadian mineral industry exports, add to the gross domestic product, and reduce unemployment. As part of this policy thrust, the central focus of the federal government's international initiatives in the area of mineral marketing has been to persuade mineral importing countries to reduce the escalating tariffs and non-tariff barriers, which are seen to inhibit the export of Canadian minerals in their more processed forms.

However, Canadian governments have not been notably successful in the pursuit of these goals, and a high proportion of Canadian mineral production is still exported in relatively unprocessed forms. According to a statement in 1974 by federal and provincial ministers responsible for mining, in "cases where increased mineral processing and mineral-based manufacturing are not feasible, desirable or economic, mineral policy should then seek assurance that Canadians are obtaining the best return from mineral exports".[9] Inter-governmental collaboration has occasionally been viewed by the Canadian government as a means to this end, although most of the inter-governmental discussions in which Canada has participated were initiated by other countries.

This paper deals with the post-1945 record of Canadian government policy towards inter-governmental regulation of international markets for minerals exported by Canada. Its focus will be on describing government policy and on explaining it by reference to key factors to be found in the structure of the mineral markets themselves, the domestic political setting, and the international diplomatic arena. The body of the paper consists of a commodity-by-commodity description and explanation of the Canadian federal government's policies towards inter-governmental market regulation. Each commodity-specific discussion is divided into two subsections: a chronological description of international negotiations and Canadian policy, and an explanation of the main factors conditioning Canadian policy towards that mineral. From this commodity-specific discussion, we will draw some conclusions about the key factors influencing the Canadian government's approach to questions of inter-governmental collaboration to influence mineral markets.

The particular minerals which will be dealt with in this paper are copper, iron ore, lead and zinc, nickel, and uranium. These have been selected because they have all been the subject of inter-governmental negotiations aimed at some sort of collaboration involving both producers and consumers. The six minerals selected are among the most important minerals produced in Canada. Together they accounted for 28.3 per cent of the total value of mineral production in Canada on average for the years 1974 to 1980, or 55.9 per cent if oil and natural gas are excluded.[10] Since each of these six mineral industries is highly export oriented, with more than 70 per cent of production on average being exported, as a group they account for a high proportion of Canadian mineral exports.

Canadian Policy Towards Regulation of Six Mineral Markets

Copper

Copper prices have been extremely unstable.[11] Copper-producing developing countries, a number of which are highly dependent on copper for their export earnings, have long sought inter-governmental regulation to deal with this problem. In 1967, the four major developing country exporters (Zambia, Zaire, Peru, and Chile) formed CIPEC, the Council of Copper Exporting Countries. Their objectives were to facilitate the exchange of information on the copper market and to promote national control of their copper industries.[12]

After prices dropped drastically in late 1974, CIPEC members agreed in November 1974 to a 10 per cent production cutback and in April 1975 to a further 5 per cent cutback.[13] Canada, along with a number of other non-CIPEC producers, was invited to join in these cutbacks but did not do so.[14] Copper-producing companies in Canada made their own production cutbacks in 1974 and 1975, not in response to a government request to do so (there was none), but rather as the standard response of private producers in times of weak demand and low prices.[15]

The Canadian government considered joining CIPEC in 1974-75. Supporters of such membership within the Department of Energy, Mines and Resources (EMR) were concerned about low and unstable copper prices and hoped that consultations among producing and consuming countries could help to overcome some of these problems.[16] Nevertheless, EMR did not recommend that Canada join CIPEC, since its member countries were perceived to be quite militant and their objectives (never realized) were clearly those of a cartel, that is, to support prices through export restrictions. Opposition to

Canadian membership in CIPEC was even stronger among the mining firms[17] and among other federal departments, especially Industry, Trade and Commerce.[18] Consequently, Canada did not join and stated that this was because of its "strong preference for producer-consumer cooperation" over producer-only action.[19]

After the unsuccessful attempts to support prices through collaboration in CIPEC during 1974-75, the developing copper-producing countries shifted their attention to the United Nations Conference on Trade and Development (UNCTAD) in the hopes of getting a producer-consumer international commodity agreement (ICA) that would be more successful than producer-only attempts to regulate the market had been. A series of meetings was held under the auspices of UNCTAD's Integrated Programme for Commodities from 1976 to 1980. Because the developing countries viewed the copper negotiations as a test of the developed countries' willingness to respond to their demands for reform of international commodity trade, the Canadian position had to be considered not only in terms of its impact on the important Canadian industry, but also in terms of its impact on Canada's political relations with the Third World.

Developing countries involved in copper production pressed hard for an ICA with a buffer stock and export controls throughout the Integrated Programme for Commodities (IPC) copper meetings, which began in September 1976. The developed countries, with Canada in the forefront, opposed the immediate establishment of an ICA and stalled in the hope that pressure for an ICA would dissipate. They insisted that further studies of the market and its problems were needed to determine whether an ICA would be appropriate and advocated the creation of a producer-consumer consultative body as a tactic to defuse pressure for an ICA. In February 1978, it appeared that a consensus had been reached to establish a consultative body roughly along the lines proposed by the western developed countries, but the consensus broke down in subsequent meetings as certain militant developing countries renewed their demand for an ICA and rejected the proposal for a consultative body as an attack on the goals sought by developing countries through the IPC.[20]

Canada has consistently refused to become involved in efforts initiated by developing countries to regulate the international copper market. Prime Minister Trudeau and some of his cabinet colleagues, motivated by their sympathy for Third World development efforts and their initial perceptions that, as a major copper producer and exporter, Canada shared an interest with developing countries in copper market regulation, initially pressed officials to adopt a forthcoming stance in the UNCTAD copper negotiations. However, officials strongly resisted this pressure and were eventually able to convince the cabinet that Canada's interests did not lie in copper market regulation.

Canadian officials opposed the regulatory schemes proposed by developing countries because price instability was not a significant problem for the Canadian industry and because the LDC proposals contained specific features that were unacceptable to Canada. The reason for the relative lack of concern about price instability lay in the existence of a two-price system in the international copper market until the late 1970s.[21] Prices in the market outside North America were determined by trading on the London Metal Exchange (LME) and tended to fluctuate widely and rapidly. However, the copper industry in the United States was highly oligopolistic, and the major producers were able to establish a producer price system based on price leadership. Instead of allowing prices to be determined on an open commodity exchange like the LME, producers in the United States set posted prices and closely followed each other's infrequent price changes.[22] The result, as is generally the case with effective producer price systems, was greater price stability; both the amplitude and frequency of copper price changes in the United States were much lower than for LME prices.[23] Canadian producers benefited more than other non-US producers from stable US copper prices because a high percentage of their sales are made in either the United States (35 per cent) or Canada (40 per cent), where they sell at US producer prices, adjusted to account for the exchange rate.[24] Canadian producers also tended to treat the cyclical instability of the copper market as inevitable and to adjust accordingly, rather than to perceive instability as a problem needing correction. These adjustments often resulted in temporary unemployment for miners in Canada, but the government's provision of the safety net of unemployment insurance and other social services has largely defused the possibility that copper industry workers would want the government to intervene and support international copper markets.

The two-price system for copper broke down in 1978 as a result of growing competition worldwide in the industry since the 1960s. During the 1960s and 1970s, nationalization in developing producing countries weakened the dominance of US-owned transnational corporations in international copper trade, and new sources of supply were developed in existing and new producing countries.[25] In response to the increased competition from foreign suppliers, the largest US producers changed their pricing formulas in mid-1978 so as to relate their prices much more closely to prices on the open market commodity exchanges. This signalled the end of an effective two-price system for copper.[26] Since that time, US and Canadian producer prices have followed open market prices very closely,[27] resulting in significantly greater price instability for Canadian copper producers. However, there is no indication that this experience has caused any change in the perceptions of government or industry in Canada about the need for inter-governmental regulation.

The major problem in recent years, as perceived by Canadian government and industry, has been declining prices in real terms. After a brief respite in 1978-79, real prices fell during the 1981-82 recession to their lowest levels since the 1930s.[28] Canadian producers and EMR officials have put much of the blame for this trend on producers in developing countries that have maintained production in the face of weak demand and depressed prices during the recessions of the 1970s and early 1980s because of the social and political costs of creating unemployment in copper-producing areas and because of their need for the foreign exchange earned from copper exports.[29] Inter-governmental collaboration has not been considered in Canada as a way to deal with this problem, largely because copper-producing developing countries have made it clear that they are not interested in measures that would force them rather than developed countries to cut back on copper production.

A number of other considerations also contributed to Canada's opposition to LDC proposals for inter-governmental copper market regulation. Studies done by and for various departments indicated that the proposed schemes would have little stabilization impact, would be costly, and would be of questionable administrative viability.[30] It was felt that the large number of producers, the differences among them in terms of costs of production and dependence on copper for export earnings and employment, and the fact that copper was often co-produced with other minerals all meant that a copper agreement would be unworkable. Canada also faced a special difficulty in that participation in any market-sharing scheme would inevitably require some degree of federal government involvement in distributing the burden of adjustment measures (export cutbacks, for example) among producing firms and provinces, each jealous of its market share and decision-making powers. Some officials also felt that an ICA created under UNCTAD auspices could unfairly restrict copper exports from Canada. As a wealthy developed country, Canada would come under diplomatic pressure to absorb a disproportionate share of export cutbacks as a concession to developing countries.[31] Alternatively, an ICA might prop up inefficient producers in developing countries[32] by giving them guaranteed market shares, or it might encourage greater production in developing countries if investors felt that enhanced market stability reduced the risks of investing in generally lower-cost developing countries.[33]

Private Canadian producers were also vehemently opposed to an ICA for copper. They felt that, given the UNCTAD context, a copper agreement would merely be a cover for an ambitious OPEC-style cartel. Copper producers also shared the officials' fears that an ICA might stimulate investment in low-cost developing countries, as well as the officials' doubts about the workability of an ICA. Other reasons for the copper industry's opposition to an ICA include its opposition to government intervention in general[34] and its fears that large stocks could depress copper prices.[35] The thrust of industry opposition is captured in the following quote from W.J. Barbour, Assistant Treasurer for Noranda, Canada's largest copper producer: "The present market system has its flaws, but replacement of the fundamental laws of supply and demand with bureaucratic manipulation of supplies and prices is likely to be an unqualified disaster in the long run."[36] The opposition of private Canadian producers to an ICA for copper was certainly one of the most important reasons for the Canadian government's opposition to a copper agreement, especially since industry spokesmen were consulted throughout the negotiations and helped to shape the government officials perceptions of the impact of an ICA.[37]

Canada's advocacy of a producer-consumer forum for copper had more to do with North-South diplomacy than it did with a belief that such a forum would help to overcome the problems of the international copper market. As explained earlier, the developing countries had made the copper negotiations a central focus of their attempts to restructure international commodity trade, and Canadian ministers, diplomats, and officials felt that Canada could not turn its back on this pressure without risking its political reputation in the Third World as a progressive northern country. The proposal for a producer-consumer forum was therefore supported by Canadian negotiators, essentially as a tactic to prevent a downgrading of Canada's reputation while avoiding meaningful economic concessions. Industry advisors from the large central Canadian firms were easily persuaded to support the idea, as they felt that by facilitating the exchange of market information, the forum could moderate price fluctuations and limit the extent of industry recessions.[38] These executives helped Canadian officials to convince the more skeptical, free-marketeering B.C. producers to go along with the idea, even though this latter group did not support the producer-consumer forum. In the end, the more militant developing producing countries rejected the proposal for a producer-consumer forum as not going far enough, and the talks collapsed without agreement on any measures to deal with the problems of the copper market. Canadian officials and their industry advisers were quite happy to see all the proposals die on the iable, but the fact that developing countries were immediately responsible for the deadlock allowed Canadian negotiators to claim that "we lost a marvelous opportunity" while breathing a sigh of relief.

Canada has made no effort to revive the idea of a producer-consumer forum since the talks collapsed in 1980. Market conditions worsened dramatically during the recession of the early 1980s, and the major lay-offs necessitated by depressed market conditions have caused mineworkers' unions to demand government-financed stockpiling to maintain production. However, the federal and provincial governments have resisted this pressure because of the high costs involved and the concern that large stocks overhanging the market would merely prolong the downturn. Instead, Ottawa has tried to alleviate conditions in the affected communities through the provision of social services such as unemployment insurance and has modified the rules of various programs to enable funds to be used to subsidize employment in minor ways. Unions and community leaders have not made any demands for government intervention in international markets. Some officials feel that a producer-consumer forum might be useful in helping private producers and western governments to convince developing producing countries to respond to market conditions, but the predominant view in Ottawa appears to be that the risk of reviving ICA proponents from their current slumber is too great to justify the call for the limited benefits of a producer-consumer forum.

Iron Ore

Iron ore prices have been relatively stable, but have exhibited a steady downward trend in real terms since the 1950s despite continually increasing steel prices.[39] UNCTAD sponsored two meetings of iron ore producing and consuming countries in 1970 and 1972, and at both meetings developing exporting countries called for the indexation of iron ore prices to steel prices. The major consuming countries, having benefited from the existing arrangements for iron ore trade, opposed changes to the status quo.[40] Canada also opposed the creation of an ICA, fearing that in a situation where world trade in iron ore was growing very rapidly, "a formal agreement might stimulate vast surpluses, encourage inefficient production, or discourage new investment ventures, depending on the price level fixed".[41] Canada's production capacity was growing rapidly as a result of large mine investments made in the late 1960s,[42] and Ottawa apparently feared that an ICA might interfere with the resulting growth in production and exports and with the inflow of further investment.

Disenchanted with the lack of response from consuming countries in these UNCTAD meetings, the developing exporting countries decided to form a producer association. The resulting Iron Ore Producers Group, formed in February 1973, conducted studies and made recommendations concerning the problems of the iron ore market. Canada and other developed producing countries were invited to join as members or participating observers,[43] and they took part in a November 1974 meeting to study a proposal for an OPEC-style producer-only association. Canada, Australia, and Brazil rejected the proposal because there was no provision for consuming country interests to be represented. Since these three countries were the largest iron ore exporters, the proposal was redrafted to explicitly exclude producer-only regulation of the market and to stress the consultative and information exchange goals of the association. Nevertheless, Canada (along with Brazil and the Soviet Union) refused to join the Association of Iron Ore Exporting Countries (AIOEC) when it was created in April 1975 because its membership did not include consuming countries.[44]

Iron ore was included in UNCTAD's Integrated Programme for Commodities, and four meetings were held in 1977 and 1978. However, nothing came of these meetings because there was little interest among the major trading countries in any sort of inter-governmental action.[45] Canada attended all of the meetings and, according to one senior official, made "the right North-South noises" without committing itself to anything. Canada opposed an ICA for iron ore, but might have supported a study group had the other countries been interested in the idea. However, they were not and the Canadian government was not unhappy to see interest in inter-governmental arrangements dissipate.

EMR conducted an internal review of the possible merits of Canada's joining the AIOEC during 1982-83, apparently in response to the extremely depressed conditions in the Canadian iron ore industry since the late 1970s. Severe competition in international markets, particularly from lower-cost producers in Australia and Brazil,[46] had severely eroded Canadian exports to Europe and Japan and had renewed the traditional Canadian dependence on the US market. However, US steel companies had been hit very hard by the worldwide decline in demand for steel, and as a result Canada's exports to the US had also declined. Nevertheless, Canada again decided against joining the association.

The question of whether Canada should join the AIOEC generated considerable debate in Ottawa, both in 1975-76 and in 1982-83. Some officials, particularly in EMR, felt that Canadian membership could help to overcome some problems for Canada resulting from the oligopolistic structure of the international iron ore market. According to one EMR report, "widely dispersed and competing sources of supply are usually confronted by concentrated demand markets."[47] In Canada's case, this market structure was reflected in the fact that US steel companies owned most Canadian production sites. The steel companies had taken advantage of their concentrated buying power and integration into iron ore production to stimulate an over-supply of iron ore, which contributed to the long-run decline in iron ore prices.[48] These officials hoped that by co-operating in the AIOEC, iron ore producers could put themselves in a stronger bargaining position vis-à-vis the oligopolistic consuming industry and thereby perhaps counter the trend of declining prices.[49]

Some EMR officials were also concerned with the lack of market transparency in the iron ore and steel industry. The high degree of vertical integration in the industry and the concomitant absence of an open, competitive market made it very difficult for Canadian officials to determine whether Canada was deriving "fair" returns from its iron ore production. The AIOEC might generate better market information with Canadian participation, and that in turn could increase the bargaining power of Canada and other iron ore producers vis-à-vis the steel companies.

These considerations initially led EMR to recommend in 1975 that Canada join the AIOEC. This recommendation was supported by some officials in the Department of External Affairs, who saw Canadian membership as a way to demonstrate Canada's sympathy for Third World concerns in the context of the heated North-South commodity debates of the mid-1970s. However, a number of other considerations weighed strongly against Canadian membership, and these were sufficient to block Canadian membership in 1975-76 and, even more decisively, in 1982-83.

The most important consideration in Canada's decision not to join the AIOEC was the vehement opposition of the Canadian iron ore producers and their parent steel companies in the United States,[50] introduced into Canadian policy-making circles primarily through sympathetic officials in the Department of Industry, Trade and Commerce. These companies were firmly against any intergovernmental regulation that could interfere with intra-corporate iron ore exports from Canada to the United States and, in particular, any attempts to raise the price at which those exports were sold. The US parent steel companies also feared that they could be subject to anti-trust prosecution in the United States if their Canadian subsidiaries participated in price-fixing arrangements at the behest of the Canadian government.

The views of the US steel companies and their affiliated Canadian iron ore producing firms carried great weight in Canadian government policy-making circles because of the dependence of the Canadian iron ore industry on markets with US steel companies. More than half of Canadian exports during the 1970s went to the United States, and most of that trade occurred between affiliated firms.[51] The prevailing view in the government was that Canada could not afford to risk alienating these steel companies by joining the AIOEC. In 1975-76, some EMR officials felt that Canada was in a strong enough market position to enable it to join the AIOEC without suffering retaliation from US steel companies. The major Canadian producers had just expanded their operations, demand was projected to grow rapidly, and Canada was diversifying its markets in Europe and Japan. These developments all indicated that Canada could play an increasingly important role in international co-operation among producers. However, by 1982-83 the loss of market share in Europe and Japan and the renewed dependence on a shrinking US steel industry convinced most EMR officials that a move to join the AIOEC would be unwise. The overriding concern of the Canadian government in recent years has been to maintain Canada's position in the US market, and the intra-corporate links that were once blamed for contributing to low iron ore prices are now valued for the protection they are seen to give to the Canadian industry: "Without US parent linkages and the protection of their heavy investment in Canada, the (high-cost) Quebec-Labrador mines would be hard-pressed to compete in today's market. They certainly would not be developed in today's economic circumstances in comparison with other world developments."[52] Officials fear that US steel producers, faced with the need to shut down some of their iron ore operations, might choose to close down Canadian rather than American operations, regardless of their cost-competitiveness, if Canada decided to join the AIOEC.

Aside from the opposition of the Canadian producing firms and their parent steel companies in the United States, the other major reason for Canada's decision (not) to join the AIOEC is the government's concern with the reactions of Canada's major trading partners to a decision to join a producer-only organization, even one that has explicitly renounced market regulation. Such a decision would violate Canada's traditional position of support only for those bodies representing the interests of both producers and consumers and would invite retaliation. The fear of retaliatory action was particularly strong during the 1982-83 review, in light of the renewed dependence on the US market and the strong opposition of the Reagan administration to inter-governmental market regulation. Some officials have suggested that Canada might have joined the AIOEC in 1975-76 if Brazil had done so, since Brazil's well-known opposition to iron ore market regulation would have allayed consuming countries' fears of the AIOEC as a cartel. Furthermore, had Brazil joined, consuming countries would have no major alternative suppliers to turn to if they decided to retaliate against AIOEC members. However, Brazil did not join the AIOEC, and Canada has stuck to its position on non-membership in commodity bodies that represent the interests of producers alone.

Canada's position as an importer as well as an exporter of iron ore also contributes to Canadian opposition to inter-governmental regulation of the iron ore market. While Canada exports far more iron ore than it imports,[53] all three integrated Canadian steel producers import substantial amounts of ore from affiliated mines in the United States and therefore oppose inter-governmental regulation that threatens to interfere with this trade. However, these companies have not perceived the AIOEC to be as cartel-like as have Canadian iron ore producers, and their opposition to Canadian membership has been muted.

Finally, the likelihood of success of any inter-governmental iron ore market regulation is extremely small. Iron ore production is widely dispersed among a large number of countries with substantially different costs of production. According to one analyst, the "absence of concentration of reserves, production, and exports, and the wide differences in political orientation of the major exporting countries would make effective collusion quite difficult."[54] Even if the Canadian government had not opposed producer-only market regulation for other reasons, its perception that the viability of a producer-only association for iron ore would be "very limited"[55] would have reduced its enthusiasm for such action.

Lead and Zinc[56]

The presence since 1960 of the International Lead and Zinc Study Group (ILZSG), an informal consultative body made up of representatives of private industry and government from both producing and consuming countries, has helped to ensure stable and renumerative prices for lead and zinc. The formation of the ILZSG was prompted by mine closures and unemployment in many countries resulting from a sharp price decline in 1957. The initiative to establish the group came from the Interim Coordinating Committee for International Commodity Arrangements of the United Nations.[57] During the course of meetings of producing and consuming countries in 1958, the United States imposed tariffs and quotas on imports of lead and zinc, a move which harmed Canada and other producers, including Peru, Mexico, and Chile. The Canadian government, in consultation with the Canadian lead-zinc industry, participated actively in meetings during 1958 and 1959 that led to the formal inauguration of the ILZSG in January 1960.[58] Some developing producing countries had called for the adoption of more ambitious measures, such as price regulation and supply controls, but Canada and other producing countries were opposed to formal regulatory arrangements. The proposal for a study group was therefore supported by the Canadian government and private Canadian producers, not only because it would help to improve market transparency but also because it served to deflect pressure for more ambitious and interventionist measures.

The ILZSG has enhanced price stability and supported price levels in three ways. First, the information exchanged in meetings of the ILZSG and the information and studies published by it have enabled individual producers and consumers to respond in more appropriate ways to market developments.[59] In this context, it is worth noting that industrial organization economists have identified good market information as one of the prerequisites for effective producer pricing.[60] Since the major world markets for both lead and zinc are characterized by producer price systems, as the ILZSG improves market information it also improves the ability of producers to operate a producer price system.

Second, ILZSG meetings have provided an ongoing opportunity for consultations among producing and consuming countries and companies, and what has evolved from this is a system of informal, voluntary inter-governmental/inter-corporate management of lead and zinc markets. During discussions of the market situation and projected levels of supply and demand, what one industry spokesman characterized as "moral suasion" is applied to those producers or governments whose actions threaten to upset the market. Emphasis is put on the idea that each country has "to do some cutting" when the market is characterized by high inventories and surplus production. On occasion, recommendations about production levels are made during meetings of the group, and these are then implemented on a voluntary, independent basis by the group members. For example, shortly after the group was formed in 1960, producing countries (including Canada) agreed upon and implemented a "voluntary arrangement. . .to restrict production of lead and zinc as a means of sharing the burden of reduced US imports".[61] Thus, there is an element of inter-governmental collaboration to supplement the private management of international markets for lead and zinc through producer price systems.

Third, the meetings provide an excellent opportunity for producers from around the world to get together without the fear of violating national anti-trust laws, since producer-consumer study groups are acceptable under both American and European anti-trust laws. The private lead and zinc-producing industry is well represented at ILZSG annual meetings: the Canadian delegation, for example, typically consists of three to five government officials and ten to twelve industry advisers representing all of the major Canadian producers. These industry representatives take advantage of the opportunity to meet privately outside formal ILZSG meetings to exchange information not shared during the public meetings and to engage in discussions that may often border on collusion. Canadian officials condone these private meetings and even regard them as a particularly helpful: the ILZSG can in this way "grease the wheels" and keep things running smoothly in the international industry.

Lead and zinc producing countries, including Canada, have shown very little interest in more formal collaboration among the governments of producing or producing and consuming countries. There was some discussion in the ILZSG of a possible international commodity agreement for lead and zinc during the mid-1960s, but most countries did not feel that one was necessary.[62] Lead and zinc were briefly considered for inclusion in UNCTAD's Integrated

Programme for Commodities in 1976, but were not included because developing countries account for a relatively small share of total world exports (28.1 and 23.8 per cent for lead and zinc respectively in the years 1979-81)[63] and also because none of the developing exporting countries depend on exports of lead and/or zinc for more than a few percentage points of their total export earnings.[64] The private Canadian industry strongly opposed suggestions for ICAs for lead and zinc, arguing "that Canada would lose its position in foreign markets and would be faced with financing the surplus production of Third World countries during times of oversupply" if ICAs were created.[65] Consequently, there have been no formal negotiations for the inter-governmental regulation of lead and zinc markets in recent years.

The Canadian government has given strong and active support to the ILZSG[66] but has shown no interest in more formal schemes for inter-governmental regulation of lead and zinc markets. A number of factors combined to make the ILZSG acceptable to the Canadian government. Membership in the ILZSG is open to consuming as well as producing countries, and Canada has a stated preference for producer-consumer over producer-only associations. The concentration of production and consumption in a relatively small number of predominantly western industrialized countries has facilitated the creation and operation of the ILZSG. Also, Canadian participation in the ILZSG was acceptable to private Canadian lead and zinc producers, who have since become strong supporters of the organization. The industry appears to have supported the ILZSG because industry spokesmen are well represented in ILZSG deliberations, because government involvement in the ILZSG does not entail formal intervention in international marketing, and also because the information exchanges and consultations that take place improve market transparency and assist the informal co-ordination of supply with demand, thereby facilitating the operation of producer price systems.[67] Industry spokesmen also feel that with the ILZSG in place it is unlikely that pressure will develop in UNCTAD for an ICA or for other measures that could damage their interests.

Canada's lack of interest in more formal inter-governmental regulation of lead and zinc markets also results from the generally satisfactory price trends of both minerals. Prices for both lead and zinc have been relatively stable compared to prices for other minerals such as copper.[68] Lead prices have declined somewhat in real terms since the 1950s,[69] while zinc prices have remained fairly constant in real terms.[70] The producer price systems that exist for both lead and zinc have contributed greatly (in combination with the work of the ILZSG) to these satisfactory price trends. International markets for both minerals are highly oligopolistic, with a small number of producers accounting for a large share of overall production and trade. In these circumstances, producer price systems based on price leadership prevail in the United States and Canada for lead and in virtually all world markets for zinc. Lead prices outside North America are based on the London Metal Exchange price.[71] Prices for lead and zinc have been higher and more stable in markets characterized by producer price systems than in more competitive markets. This is particularly true of the US market as compared to overseas markets for both minerals.[72] Canadian producers have therefore benefited from the fact that a large proportion of their sales are made in either the US market[73] or in the much smaller Canadian market, where sales are made at US producer prices that have been adjusted to account for the exchange rate.[74]

Nickel

The history of conditions in the Canadian nickel industry and policy responses to them can be conveniently divided into three periods, with the late 1960s and the 1976-77 fiscal war as the dividing marks. During the first period, the International Nickel Company of Canada (Inco) dominated the world market for nickel. Inco owned the "uniquely rich sulphide ore deposits" in the Sudbury area, which gave Inco control of 75 to 90 per cent of non-communist world output in the first half of this century. Inco's market share declined during the 1950s and early 1960s, but even in the late 1960s Inco still accounted for roughly half of world production and continued to dominate the world market.[75]

During the first period, Inco was able to set the world price for nickel in accordance with its long-term interests. "Inco set its price, other companies sold the amounts they wished, and Inco supplied the remainder of the market, which was the major portion."[76] Instead of closely following cyclical fluctuations in nickel markets, Inco pursued a policy of maintaining production at relatively constant levels and using changes in inventory levels to accommodate changes in demand. Inco deliberately avoided raising its prices at times of peak demand and instead rationed the supply of nickel to its customers. Similarly, when demand fell below the amount Inco wanted to supply at the posted price, Inco built up huge stockpiles to avoid reducing its price or production levels.[77]

The demand for nickel is very volatile, yet Inco's market strategy resulted in remarkably stable and profitable nickel prices during the 1950s and 1960s.[78] Inco's management of the international nickel market was particularly impressive from the perspective of those Canadians dependent on the nickel industry. Its policy of maintaining production at relatively constant levels meant that employment in the nickel-producing communities was much more stable than is the norm for resource-based communities in Canada.

By the late 1960s, however, conditions in the international nickel market were changing to the disadvantage of the Canadian nickel industry and those dependent on it. Production from existing sulphide deposits in Canada could not be expanded as rapidly as the growth of world demand during the 1950s and 1960s, so attention began to focus on the very large and widely dispersed nickel reserves contained in lateritic ores.[79] After 1960, the nickel output of non-communist countries other than Canada grew four times faster than in Canada,[80] and by the early 1970s, Canada's and Inco's shares of the world market had been seriously eroded. While Inco was still the largest producer and the price leader, it now had to pay much more attention to the responses of other major producers to its pricing policies.[81]

It was during this period of diminished but still considerable Inco market power that the first indications of Canadian interest in inter-governmental collaboration emerged. In April 1971, the Minister of EMR, Joe Greene, met with Australian officials in Canberra to discuss natural resource issues of common concern. Inco was suffering badly from a cyclical slump in nickel demand,[82] and Japanese buyers were being particularly aggressive in pressing for lower prices. In this context, Greene proposed to the Australians that they jointly establish a consultative mechanism to prevent excessive competition from developing nickel and certain other minerals for export sales, particularly to Japan. The Australians allegedly refused to establish such a mechanism, but did agree to continue discussions.[83]

Canada's market position continued to deteriorate during the 1970s. Inco's share of the non-communist world market declined from roughtly 50 per cent in the late 1960s to 38 per cent in 1975.[84] Optimistic projections of future demand growth based on demand growth rates of the 1960s had stimulated the development of a number of lateritic nickel deposits,[85] many of which were located in developing countries that badly needed both the hard currency that could be earned from nickel exports and the employment generated by nickel mining. Furthermore, the new projects carried high debt loads, and after the oil price increases of 1973-74, lateritic producers also suffered from high energy costs which led inevitably to high operating rates. All of these factors encouraged high levels of output, so the laterite producers have tended to be less willing to cut back production and exports in times of weak demand than are the traditional sulphide producers.[86]

Inco lost much of its ability to influence prices as a result of the development of these new deposits.[87] By the mid-1970s, "a non-co-operative oligopolistic industry structure"[88] had emerged. Privately-owned producers in the developed countries attempted to maximize profits by matching production to demand, while government-owned or -controlled producers in developing countries sought to maximize revenue and employment by maintaining high levels of production, virtually without regard to the level of market demand.

The impact of these changes on the Canadian nickel industry was demonstrated dramatically in 1976-77. A period of depressed demand beginning in 1974 coincided with the coming on stream of many of the new projects, most of which continued to produce at near-capacity levels during the entire 1975-78 slump.[89] Stiff competition among producers for a shrunken market and the desire of new producers to attract customers triggered the first real price war for nickel. "For the first time. . .market conditions were playing a major, rather than a subordinate, role in determining the price of nickel".[90] Weak demand and the price war had forced Inco and Falconbridge (the other major Canadian producer) to accumulate so much excess stock that they found themselves compelled to cut back production and lay off workers. Announcements of layoffs were made in October 1977, sparking strong protests from the affected unions, the press, and the politicians.[91] The most interesting of these reactions was that of Prime Minister Pierre Trudeau, who suggested that the government might try to form an international nickel cartel to raise prices above their depressed levels, just as it had done in the case of uranium. Mr. Trudeau also raised the possibility of a compromise arrangement between producing and consuming countries.[92]

The bureaucracy and the nickel industry were caught off guard by Mr. Trudeau's cartel suggestion, and both groups were opposed to the idea. Officials speculate that Trudeau's comments were a characteristic off-the-cuff response to questions from the press in the context of strong pressure from the mining unions and the community for a federal government response to the lay-offs. Canadian officials had to convince US officials that the Prime Minister's comments were not to be taken seriously, and that Canada had no interest in a nickel cartel. Inco, conscious as always of the risk of anti-trust investigation in the United States, quickly dissociated itself from the suggestion. In a public statement, Inco pointed out "that it ha[d] had no discussions with anyone regarding a cartel" and that it opposed "any such concept" as a nickel cartel which, it argued, would cause the Canadian nickel industry to lose its international reputation as a "reliable and competitive" supplier and would therefore do more harm than good.[93]

The nickel industry was also opposed to the proposed, formal producer-consumer ICA because it would lead to greater government intervention in international marketing and could trigger another investigation by US anti-trust authorities. Canadian nickel producers also doubted that an ICA for nickel would be effective and felt that since supply was growing faster than demand, consuming countries would have little incentive to join.[94]

While Prime Minister Trudeau's public comments did come as a surprise, they also reflected the government's real interest in the problems of the nickel industry and the fact that Cabinet had been considering a number of options for government action to deal with these problems. These options, considered with varying degrees of seriousness, included government financing for nickel stockpiling (nickel mining unions were calling for such a stockpile), a nickel study group to improve market information, a producer-consumer ICA for nickel, perhaps under UNCTAD auspices, and the cartel mentioned by Trudeau. Concurrent with these cabinet discussions in Canada, the Australian government was becoming interested in the idea of an international nickel discussion group (INDG) to improve the quality and availability of information on the international nickel market. Canadian officials were already thinking along similar lines and quickly gave their support to the Australian minister responsible for natural resources when he brought up the idea during a visit to Ottawa in early 1978. The Australian government held bilateral consultations with the governments of other major producing and consuming countries during 1978 to gauge the level of support for an exploratory international meeting on nickel, the objective of which "would be to consider the establishment of a producer-consumer forum whose function(s) would be analogous to those of the International Lead-Zinc Study Group".[95]

The first meeting was held in London in 1979 with representatives from Australia, Canada, France, Japan, the United Kingdom, the United States, and West Germany in attendance. A number of subsequent meetings have been held but progress has been slow and consensus has still not been reached on the establishment of an INDG. In October 1982, the other participants agreed to permit Canada and Australia to canvass all other countries with at least one per cent of world exports or imports (about thirty in total) to determine the degree of international support for the proposal, but did not commit themselves to the eventual establishment of an INDG. The reaction of this larger group to the proposals was mixed, with no outright rejections but also little enthusiastic endorsement.

The INDG discussions have moved slowly because of the reservations of the major consuming countries. In the current situation of persistent oversupply and low prices, consumers naturally do not feel the same need for measures to ameliorate market problems as do producers. Furthermore, despite the rather innocuous information-sharing objectives of the proposed INDG, some consuming countries (especially the United States) fear that it might be the first step towards greater government intervention in the market and perhaps even a nickel cartel. The fact that Canada and Australia, the main proponents of an INDG, were both involved in the uranium cartel has certainly encouraged these fears, as did Prime Minister Trudeau's comments in 1977 regarding a nickel cartel.

The international nickel market has continued to evolve in the direction of greater competition during the slow INDG discussion process. Trading of nickel metal was introduced at the LME in April 1979. Initially the LME was ignored by the major nickel producers who continued to sell at producer prices, and trading on the LME was very light for the first couple of years. However the LME nickel price began to have an increasing impact on "the pricing policies and strategies of the major producers. . . . By mid-1982 the major nickel producers gave up attempts to realize posted prices and changed their pricing strategies, adopting more competitive and flexible pricing policies."[96] This final breakdown of the producer price system was accompanied by significantly greater price volatility, only partly mitigated by the opportunity provided by the LME futures market for forward pricing and hedging.[97]

Canada's support in recent years of an INDG, in contrast to its lack of interest in inter-governmental involvement in the nickel market during the 1950s and 1960s, is largely the result of dramatic changes in the nickel market and in the structure of the industry traced above. By the mid-1970s, slow demand growth combined with a rapid increase in the number of suppliers had forced Canadian producers to be more responsive to changes in demand and price. In contrast to the earlier period, when Inco was able to set prices at a level largely sufficient to cover costs of production, producers now had to adjust costs to prices.[98] As a result, Canadian producers have had to shut down their Canadian operations for lengthy periods and institute temporary and semi-permanent cutbacks in their lateritic ore operations in the Dominican Republic, Guatemala, and Indonesia.[99] Employment in nickel production has become much more variable than it was during the lengthy period of Inco market domination. Production cutbacks and lay-offs in the nickel-producing regions of Sudbury, Ontario and Thompson, Manitoba raised the ire of unions, community leaders, and provincial governments. All of these groups put pressure on the federal government to do something to help the industry.

Cabinet considered a number of options, and the creation of an INDG appeared to best meet the concerns of the Canadian government. The mining unions and some regional spokesmen had called on the federal and Ontario governments to purchase and stockpile nickel to maintain production during the slump. The federal government refused to do this because of the large costs involved, the unfairness of taking such action for nickel but not for other minerals, and the fears (shared by the producing firms) that a large stockpile would overhang the market and depress prices without much prospect of ever being sold at a profit.[100] The possibility of creating an ICA for nickel was also considered but was rejected because of the opposition of the industry (as described earlier), the perception that the major nickel-consuming countries would not support an ICA, and doubts within the government about the workability and benefits for Canada of an ICA for nickel. A nickel cartel was not given much serious consideration, despite the impression created by Prime Minsiter Trudeau's comments, because it was inconceivable given the hostile reaction to such an option in the United States, particularly in light of Canada's recent participation in the uranium cartel. There were also serious doubts that efforts to manage the nickel market could succeed without the co-operation of the major consuming countries.

An INDG appeared to hold some promise of benefits for Canada while avoiding the pitfalls of the other options. From the federal government's perspective, support for an INDG enabled politicians to demonstrate to constituents and to the provinces that they were doing something to meet the concerns of the affected groups. The Ontario and Manitoba governments have been closely involved in nickel discussions in Canada and have supported the INDG initiatives. Consequently, the nickel industry's problems have not given rise to serious federal-provincial conflict.

An INDG could also meet the perceived need for more extensive, up-to-date, and widely available market information. The Canadian government had been caught off guard by the rapid and unexpected collapse of the industry in the mid-1970s, and felt that a source of information independent of Canadian producers could contribute to the government's efforts to keep on top of conditions in the industry.[101] Officials also felt that better information on consumption trends could help the industry to avoid a repetition of the over-building of capacity in the 1970s that had led to the current problems. This is one reason for the Canadian government's continuing emphasis on getting consuming countries involved in the INDG. An INDG would also promote consultations among producing and consuming firms and governments, and Canadian officials hoped that these consultations would help to convince developing, producing countries of the need to be more responsive to market forces.

The INDG proposals compared favourably with other options for action, in part because they did not draw the same opposition from the nickel industry as proposals for a stockpile, an ICA, or a cartel. Nevertheless, it took more than two years of intensive lobbying by government officials to convince the Canadian producing industry to support the INDG proposals. Some opposed what they saw as another manifestation of growing government involvement in the private sector. Inco was concerned that it would be forced to share its extensive information on the international industry without receiving anything in return. Officials also had to deal with the widespread feeling that the effort being directed to the creation of an INDG was misplaced: from the industry's perspective, the only thing that could really help was a sustained world economic recovery strong enough to stimulate demand for the investment goods that constitute the major end-use for nickel. The best the government could do in the meantime was to help industry control costs and increase productivity.

The INDG proposals also stood the best chance of being accepted by the governments of consuming countries, which most officials felt had to be involved if international action was to be effective. In order to encourage consuming countries to participate and to allay the fears of private Canadian producers, officials have been adamant that the organization is intended solely to facilitate the exchange of information without attempting to regulate production, trade, or prices, and have argued that greater market transparency alone could help to stabilize the industry. Some officials do feel that more formal arrangements might become desirable if conditions in the industry worsen and believe that the existence of an INDG might facilitate the implementation of such arrangements should they become necessary. But for the time being, the genuine Canadian preference is for an INDG concerned solely with information-sharing and consultation.

Uranium

The first market for Canadian uranium developed during World War Two with the Allied nuclear weapons program. The industry expanded rapidly in the early 1950s to supply the needs of the American and British nuclear weapons programs. The US Atomic Energy Commission (AEC) in particular stimulated Canadian production after 1953 by agreeing to buy all of the uranium that Canadian producers could supply at highly attractive prices.[102] These incentives created boom conditions in the Canadian uranium industry during the mid-1950s, and by 1959, when output reached its peak, uranium was the most valuable mineral produced in Canada. Uranium was also a leading earner of foreign exchange (especially US dollars), ranking as Canada's fourth most valuable export in 1959 and accounting for 7 per cent of total Canadian exports.[103]

However, the uranium boom was short-lived. By the mid-1950s the AEC realized that too much uranium was being brought into production and so it stopped signing new contracts for Canadian uranium in 1956 and in 1959 announced that it would not exercise its options to purchase additional supplies from Canadian producers. Since AEC purchases accounted for 90 per cent of Canadian output, these decisions would have virtually shut down the Canadian uranium industry by 1963, when the existing contracts ran out. All countries that had contracts with the AEC were affected by its purchase cutbacks, but "Canada was probably most severely hurt by the sudden shrinkage in world demand, because it was the producing country in which uranium weighed most heavily in the national economy."[104] In order to cushion the blow, the Canadian government negotiated arrangements with the US and British governments to stretch out contracted purchases until 1966 and to allow contracts to be transferred from high-cost to low-cost producers.[105] The federal government also instituted a number of stockpiling programs during the 1960s, which cost well over $100 million.[106]

The uranium market remained very depressed throughout the 1960s. However, both government and industry in Canada had high hopes for increased demand for uranium coming from soon-to-be-developed nuclear power generation and viewed the stretch-out arrangements and the stockpiling programs as measures to help the industry and its dependent communities weather what was perceived to be a temporary slump.[107] The US market held the greatest potential, but in 1964 the AEC passed regulations prohibiting American utilities from using foreign uranium in their nuclear power reactors.[108] The Canadian government made repeated representations to the US government about this effective import embargo but without success.[109]

By the early 1970s, uranium prices had fallen to extremely low levels, especially outside the United States. These prices reflected delays in the development of commercial nuclear power generation, worldwide mining over-capacity, and the huge private and government-owned stockpiles hanging over the market.[110] Two developments in 1971 made prospects for improvement in the uranium market look distinctly worse. Discoveries of large deposits in Australia, which reportedly could be brought into production for as little as $2.00 per pound, threatened Canadian producers with severe competition in international markets.[111] Secondly, the AEC announced that it would use the US monopoly on enrichment services to help dispose of the uranium stockpile it had built up during the 1960s. All users of American enrichment services would be required to supplement the uranium they sent to the AEC for enriching with uranium from the AEC stockpile.[112] In effect, the US government was now competing with foreign producers in international uranium markets at the same time as it excluded them from the United States, by far the largest commercial market for uranium.

During 1970 and 1971, senior Canadian officials met with officials from a number of producing and consuming countries to explore the possibilities for international co-operation. As uranium consumers, Japan and West Germany showed little interest in inter-governmental market regulation to support uranium prices. Officials in Australia (already expected to become a major producer), France (with major uranium deposits in its former African colonies), and Britain (the home base for Rio Tinto Zinc, a major uranium producing company) were generally interested in, but were not optimistic about the prospects for a successful producer-consumer arrangement.[113]

The Canadian government concluded from these discussions that a producer-consumer arrangement was not feasible, so in the fall of 1971, Cabinet directed senior EMR officials to explore the possibility of a producer-only arrangement for uranium.[114] The major international uranium-producing companies were also becoming very interested in international collaboration to deal with depressed market conditions, so that in February 1972 government officials and industry representatives held parallel meetings in Paris to discuss international collaboration. The inter-corporate meetings were called by Uranex, the French government-controlled producer, while the inter-governmental meetings were called by Canada.[115]

The prospects for an effective cartel were favourable. In the first place, all existing producers had suffered badly from depressed market conditions and were therefore predisposed to favour government support of the international market.[116] Second, uranium production was highly concentrated. Canada, France, and South Africa controlled the vast majority of non-American western world uranium output, and production and marketing within each of these countries was highly concentrated in a small number of firms or government agencies.[117] Third, the political diversity among producers of uranium was not nearly as great as that among producers of most minerals; all major producing sites were either located in or controlled by Western developed countries. Fourth, demand for uranium is extremely inelastic in response to changes in price. Uranium only accounts for about 5 per cent of the total cost of nuclear electricity generation; most of the cost is accounted for by the very large capital investment required for the construction of nuclear power plants. "Since there are no substitutes for uranium in nuclear power generation, once the investment funds have been committed, uranium will be bought at any price within a very wide range."[118] Finally, the price elasticity of supply outside the colluding group was low, as Canada, South Africa, France, and Australia controlled a large proportion of then-known world uranium reserves. This meant that the cartel could raise prices without stimulating the rapid development of competing supplies.[119]

The uranium cartel was created after a series of meetings held between February and June 1972. Canadian officials played a leading role in these meetings and in shaping the compromise that was eventually reached.[120] The quotas agreed upon after much dispute gave Canada the largest share (33.5 per cent) of the market for the 1972-77 period. The domestic markets of France, South Africa, Canada, Australia (the four cartel members), and the United States were excluded from these arrangements. Minimum prices for deliveries in the 1972-78 period were established, while prices for deliveries in the post-1978 period were to be based on an escalating minimum price or on the world market price at the time of delivery. A secretariat was established in Paris to allocate sales among the various producers in accordance with the agreed quotas, and a procedure for bidding for contracts that would maintain the appearance of competition was established.[121]

The Canadian government had to overcome some domestic problems regarding Canadian participation in the cartel. The Combines Investigation Act imposed certain restrictions on export cartels, while Gulf Minerals Canada Limited, a potential uranium producer, was concerned that the cartel would interfere with its marketing arrangements and cause it to contravene US anti-trust laws. Cabinet eventually decided to use an Order-in-Council to give the Atomic Energy Control Board (AECB) greater powers to regulate exports and to set minimum export prices--and then decided to use the AECB to implement the cartel arrangements.[122] This process enabled Cabinet to circumvent Parliament and maintain the secrecy of the arrangements, it removed the participating companies from the threat of prosecution under the Combines Investigation Act,[123] and it assured Gulf that it would be able to demonstrate to potential US anti-trust investigators that its participation in the cartel had been compelled by the Canadian government.

While the cartel was supposed to be secret, its existence was widely known in the industry and, more importantly, among the governments of consuming countries.[124] What is interesting is that while the Canadian government tried to keep the cartel secret from the Canadian public, it did not attempt to keep the cartel secret from the governments of the major consuming countries. Canadian officials kept the US government informed of the early cartel meetings and the arrangements being devised.[125] The West German and British governments were kept informed of cartel developments through the links of these governments with Uranerz (which is Gulf's partner in the Rabbit Lake development in Saskatchewan) and Rio Tinto Zinc respectively.[126] None of the governments of major consuming countries complained about the cartel. Protests in the United States eventually came from Congress and the courts, while the Carter administration and the State Department attempted to minimize the impact of these protests on relations with Canada.[127]

The cartel was in operation from 1972 to 1975. Uranium prices jumped remarkably during the 1972-77 period, from less than \$6 per pound in July 1972 to more than \$42 per pound by July 1977, an increase of 600 per cent.[128] But factors other than the uranium cartel were largely responsible for this increase. Demand for uranium increased sharply, as a large number of nuclear power generating plants finally began to come on stream. This coincided with changes in the method of contracting with the AEC for enrichment services, the revelation that Westinghouse (a major manufacturer of nuclear power reactors) had contracted to sell far more uranium than it actually owned or had contracts to buy, and the fears about security of supply for energy consumers generated by the oil crisis. Utilities went on a panic buying spree, contracting for as much uranium as possible and as quickly as they could, virtually without regard to price.[129] The cartel fell further and further behind rapidly rising market prices during 1974, and the Canadian government withdrew quota and minimum price directives in early 1975.[130] Prices continued to climb rapidly even after the cartel ceased to play a leading role in setting prices. Nevertheless, the cartel did contribute to the increase in prices from 1972 to 1974 and helped producers to take advantage of rising prices in the subsequent period. "[C]ompetition among uranium suppliers virtually ceased in early 1973," and by early 1974, "the trust and cohesion established among producers had greatly increased their bargaining power and permitted them to turn the emerging events in the uranium market to their own advantage."[131] The uranium cartel also led the way from fixed price contracts to world market price contracts, whereby future deliveries would be made at the then-prevailing world market price or at an escalating floor price, whichever was higher. This enabled producers to take advantage of any increases in price over the life of the contracts. While the cartel members were the first to adopt world market price contracts, they were quickly followed by US producers who saw the advantage of such contracts in a period of rapidly rising prices.[132]

The uranium-producing companies established the Uranium Institute to supersede the cartel in June 1975, by which time the cartel had ceased to function. The objectives of the Institute as constituted stressed the need to improve market information, although cartel members had originally intended to continue their market co-ordination under the Institute's auspices.[133] Initially, only producing companies could become full members, but after reports that the organization was fixing prices, the membership policy was changed in December 1975 to allow uranium-consuming companies to become full members, and clearance was received from the US Department of Justice to enable US firms to join without fear of violating US anti-trust laws.[134]

Some observers have speculated that the cartel continued to operate secretly or tacitly as late as 1976-77, basing their conclusions in large part on the observation that prices stopped rising only once they reached the $40 per pound level, an attractive even number.[135] Co-ordination need not have been formal: "under existing market conditions and with the close relationships developed among cartel members and their governments in earlier years, the objective of monopolistic pricing should have been relatively easy to pursue, even if the formal cartel apparatus was scrapped in 1975."[136] However, perhaps a more persuasive explanation focuses on the impact of the market developments discussed earlier, combined with non-co-ordinated government decisions in the cartel member countries. France withdrew from the export market in the wake of the energy crisis, South Africa cut back exports as an unintentional reaction to high gold prices (uranium is produced in South Africa as a by-product of gold mining), and the Australian government postponed the development of uranium deposits in 1974. This left Canada as the only country with a substantial amount of uranium available for export.[137] The Canadian government used Canada's near-monopoly of international uranium sales to assume "an aggressive role in assuring that any uranium sold for export was sold at the highest possible price."[138] In October 1973, the Canadian government decided not to approve exports to the United States at less-than-cartel prices.[139] In 1975, the AECB encouraged Canadian producers to renegotiate earlier contracts to reflect the then much higher prices. In 1977, the AECB required that all new contracts must provide for renegotiation in future years to reflect world market prices and for escalating floor price clauses that would protect producers if prices fell.[140]

The high prices of the mid-1970s stimulated uranium production in a number of countries, and the Canadian share of non-communist world uranium production fell as a result from 22 per cent in 1976 to 16 per cent in 1980.[141] At the same time, interest in nuclear power generating was fading, particularly in the United States (still the largest commercial market for uranium), and this reduced demand for uranium. By 1979, expanding supply had combined with stagnating demand to again put pressure on uranium prices. The Canadian industry as a whole has been sheltered to some degree from these adverse market developments, both by the high prices specified in long-term contracts negotiated in the mid-1970s[142] and by the high proportion of its exports going to Western Europe and Japan, where the demand for nuclear power and uranium has held up better than in the United States.[143] Even if these factors are insufficient to maintain the Canadian uranium industry during the current slump, it is unlikely that Ottawa will look again to international collaboration among producers. The number of producers, particularly from the developing world, has grown significantly since the early 1970s, and this would make collaboration more difficult. Furthermore, Canada came under intense fire in the United States for its role in the uranium cartel, and this experience made the Canadian government much more wary of participation in producer-only cartels.

Canadian participation in the uranium cartel in the early 1970s contradicted Canada's stated policy that it would only participate in arrangements involving both producing and consuming countries. A number of factors combined to produce this apparent departure from traditional Canadian policy. The problems facing the uranium industry were, from the perspective of the Canadian government, much more serious than the problems faced by any other Canadian mineral industry in the period under consideration. Had the downward trend in prices continued, the industry would have faced total collapse. As it was, uranium production as it stood in Canada by the early 1970s was dependent upon heavy government subsidies. The collapse of the Canadian industry would have created severe social and economic dislocations in those northern Ontario communities that existed primarily to service the uranium mines, and this could have created problems for the Liberal government in the impending federal election.[144] Furthermore, the uranium-producing industry is central to the government's strategy with respect to the CANDU system. If Canada had lost the capacity to produce and export the large volumes of natural uranium needed to fuel CANDU reactors, the attractiveness of the system to overseas buyers might have been reduced.[145]

The case of uranium is also exceptional in that the potential for successful market regulation was relatively high. Domestically, the federal government's jurisdictional authority is more extensive over uranium than it is over other minerals. In 1946, in recognition of the strategic importance of uranium as the raw material for atomic weapons production, Parliament created the Atomic Energy Control Board and gave it regulatory authority over all aspects of uranium production and trade. This gave the federal government the regulatory powers over uranium that provincial governments have over all other minerals.[146] Furthermore, the problems facing the industry were serious enough to generate a broad consensus among interested parties in Canada. Also, as noted above, the international structure of the uranium market was much more conducive to collaborative action than was the case for any of the other minerals.

Nevertheless, the decision to participate in the cartel came only after an acrimonious debate in cabinet and among senior bureaucrats. Opposition to the cartel centred in the Departments of Industry, Trade and Commerce and External Affairs and focused on the arguments that to join the cartel would not only violate the principles of a liberalized, multilateral trading system traditionally supported by

Canada, but would also invite retaliation from Canada's major trading partners.[147] The fact that this opposition did not prevail reflects the strength of the considerations outlined above and the climate of opinion in Ottawa in the early 1970s. A resurgence of Canadian economic nationalism combined with resentment of American policies (not only the uranium import embargo and stockpile sales, but also President Nixon's 1971 import surcharge) to make Canadian policy-makers more willing to assert Canada's economic interests independently of the United States and other major trading partners.[148] The very strong support given to the cartel idea by EMR and especially its Deputy Minister, Jack Austin, also played a major role in overcoming opposition from the traditional foreign policy departments. As an indication of the dominant role played by EMR, it is notable that Canadian delegations to cartel negotiations were dominated by EMR officials and representatives of the private Canadian producers, while External Affairs and Industry, Trade and Commerce were essentially not involved. This helps to account for the fact that sector-specific economic considerations weighed more heavily in the Canadian position than did the broader trade policy and diplomatic considerations that have been traditional concerns of the latter two departments.[149]

Even though participation in the uranium cartel did represent a break with traditional Canadian policy, it is worth noting that the government took a number of steps to minimize the impact of this new departure. The cartel option was chosen only after the possibilities of a producer-consumer arrangement had been exhausted. Once the decision had been made, Ottawa made a point of informing the American government and made no serious attempts to keep the cartel secret from the governments of the other major industrialized consuming countries. The lack of protest from these governments must have reduced fears of the diplomatic and retaliatory consequences of participation in the cartel. Conversely, Canadian officials and cabinet ministers, along with their counterparts from other cartel member countries, sought to prevent the cartel from becoming public knowledge.[150] The Canadian government wanted to avoid the complications and political risks associated with a domestic scrutiny of the cartel and of Canada's role in it, and sought as well to avoid some of the international repercussions of the break with stated Canadian policy. During the early 1970s, Canada refused to join raw material producer associations initiated by developing countries (such as AIOEC and CIPEC) on the grounds that consumers were not involved. The revelation of Canada's active role in the uranium cartel could have compromised this diplomatic stance.[151]

Conclusion

Three types of factors influence Canadian policy toward inter-governmental collaboration regarding mineral markets: those related to the need of the producing industry to return a profit, those related to the desire of mine workers and their communities to maximize and stabilize employment, and those related to non-sector-specific government policy considerations arising out of the wider economic and political environment in which Canadian mineral trade policy is made. Before going into the details of these different types of factors, a few words on the policy-making process itself will help to explain how the different factors come to be considered and why the private industry's need to return a profit dominates Canadian policy.[152]

Canadian positions toward inter-governmental collaborative efforts are usually determined by officials, who are in close consultation with the affected industry. Officials from the Departments of Energy, Mines and Resources, External Affairs, Industry, Trade and Commerce (the Trade section of which was recently merged with External Affairs), and Finance meet inter-departmentally to determine a Canadian position to be sent to the relevant cabinet ministers (or, more rarely, to cabinet as a whole) for approval. Ministerial approval is usually just a formality; only in exceptional cases do ministers take issue with the advice of their officials on these issues.

These policy-making procedures leave little room for input from elected politicians, who are involved only at the level of encouraging officials to do something in response to the plight of communities affected by international market fluctuations. The low level of cabinet involvement in policy in this area is due in part to a lack of the technical expertise on the part of the minister, the time, and the inclination to delve deeply into issues of mineral trade regulation. Other issues confronting cabinet have much greater political and economic significance. Officials also seek to ensure that their work does not attract political attention by being sensitive to the concerns of politicians, avoiding controversial, non-traditional positions, and consulting closely with industry. Officials usually prefer not to involve the politicians in the process because of their concern that politicians, subject to pressure from constituents in mining communities and sympathetic to Third World demands for market regulation, might favour positions that officials feel are inconsistent with Canadian interests.

The officials who effectively determine Canadian policy are very open to input from the industry. Many of these officials, particularly in EMR and certain branches of the Department of Industry, Trade and Commerce, perceive their function largely in terms of serving the mining industry and representing its views within the government. On-going contacts between industry and the bureaucracy on a wide variety of mining-related issues and the frequent interchange of personnel between the two sectors also help to ensure that government officials are sensitive and responsive to the attitudes of industry. Mining executives are consulted extensively from the earliest stages of the policy-making process with respect to a particular collaborative proposal, and are well represented on Canadian delegations to intergovernmental negotiations. These contacts and consultations give the mining industry the opportunity to influence government policy at all stages.

No other domestic group in the sector benefits from such consultations initiated by sympathetic officials. Mineworkers' unions and community spokesmen have minimal contact with the relevant branches of the federal government. This means that their interests are represented in policy-making circles primarily through the responsiveness of elected politicians and officials to the problems of constituents. This channel is important in that it helps to stimulate action by Ottawa when unstable or depressed international markets create problems in the Canadian mining regions, but it does not allow for input from labour or the communities with respect to the specific types of action being considered. The specific forms that Canadian policies toward collaborative inter-governmental efforts to influence mineral markets take are effectively determined by officials working in conjunction with the private industry. However, Canadian policy probably would not be very different from what it has been even if politicians, mineworkers' unions, and community spokesmen were more involved in the policy-making process. Producers are in a strong position to influence government policy, and in any case their interests with respect to international action do not often conflict with the expressed interests of mining unions and communities.

The perceptions of the private industry and of government officials about the interests of the producing companies themselves in proposed collaborative inter-governmental measures are the most important factors influencing Canadian policy. The initial factor affecting the level of interest in inter-governmental action is conditions in the Canadian industry. Only in cases of unusually severe structural market problems that strain the ability of the industry and dependent communities to adjust has the Canadian government been interested in inter-governmental co-operation. In normal times, the federal government is perfectly willing to let private industry manage international markets and respond to cyclical market instability in its own way, intervening only to provide a safety net of social services to help individuals and communities to weather the temporary downturns.

Many export markets for Canadian minerals have been characterized by producer price systems, which have provided Canadian exporters with somewhat higher and more stable prices than have prevailed in export markets not so characterized. This is particularly true of the crucial US market, where Canadian producers have benefited from preferential market access because of lower transportation costs and Canada's reputation as a familiar and reliable supplier.[153] Similarly, Canadian producers are occasionally part of integrated international operations, which have provided them with assured markets. This preferential access to stronger, more stable markets for copper, lead and zinc, and the existence of intra-corporate international marketing arrangements for iron ore (and uranium, in the case of Gulf) have reduced the interest of Canadian producers in inter-governmental measures to stabilize and support prices and have given rise to a certain opposition to inter-governmental regulation that could interfere with private market management or with such intra-corporate marketing arrangements. It is only in those cases where Canadian firms produce for export to markets that are not subject to private management (uranium and recently, nickel) that the federal government has sought inter-governmental action to stabilize or support markets.

The strong competitive position of Canadian producers in international markets has also influenced the attitude of Canadian mining firms and officials to inter-governmental regulatory proposals. Canada's resource endowment and the highly-developed technology and management skills of the mining firms themselves help ensure that Canada will obtain a satisfactory share of open, competitive international markets. This competitive strength makes inter-governmental market support unnecessary and gives rise to fears that regulation could interfere with the exploitation of competitive advantages. In particular, Canadian producers and officials tend to see most Third World proposals for market regulation as attempts to prop up inefficient, uncompetitive producers by supporting international prices at artificially high levels.

This leads to the fear that Canada could find itself subject to diplomatic pressure to accept a disproportionate share of the burdens of market regulation needed to maintain the viability of LDC-producing industries as a concession to developing countries. Diplomatic pressure of this sort could become a serious problem if negotiations for copper, iron ore, and nickel market arrangements ever overcame the other obstacles that have so far blocked progress. Canadian officials argue that they would never submit to such pressure, but such a stance would tarnish Canada's diplomatic reputation in the Third World.

From another perspective, one of the reasons for Canada's competitive advantage in minerals is the country's reputation for political and economic stability compared to that of most developing countries. This reputation has enabled Canada to attract sufficient investment to develop competitive industries. The industry and the government both fear that if inter-governmental regulation did succeed in stabilizing mineral markets, and if this reduced the risks of investment in developing countries for international mining companies, Canada's relative attractiveness to foreign capital over these generally lower-cost countries might be diminished. This could lead to a decline of investment in the Canadian industry.[154]

The traditional free-enterprise philosophy of Canadian mining executives also influences Canada's approach to proposals for inter-governmental collaborative action. The mineral industry in Canada is by nature "vociferously opposed to government regulation or interference,"[155] and is especially opposed to government intervention in mineral marketing. This traditional opposition has been strengthened by the industry's perception that earlier attempts by governments to intervene in mineral markets did much more harm than good. In the case of proposals arising in the UNCTAD context, there was a great fear in the mining industry that incompetent, pro-Third World, anti-capitalist UNCTAD bureaucrats working with their allies in the Third World would attempt to drive prices up to artificial, unsustainable levels, and this would force efficient producers in Canada and other developed countries to cut back production to make room for inefficient Third World producers.[156]

Perceptions within the industry and the bureaucracy of the workability and the balance of costs and benefits for Canada of the various proposals for inter-governmental collaboration also have a strong influence on Canadian policy. Most officials are open to the idea that formal inter-governmental regulation may be appropriate to deal with certain types of problems in certain commodity markets, but do not feel that ICAs as proposed by developing countries are appropriate for those minerals exported by Canada. Officials and mining executives believe that inter-governmental attempts to support and stabilize mineral prices would interfere with the exploitation of Canada's competitive advantage, would introduce distortions and rigidity into markets, and would hurt producers in the long run. High, regulated prices would encourage consumers to switch to substitutes and would stimulate the development of competing sources of supply, and, as previously noted, Canadian producers might actually suffer net revenue losses if markets were stabilized by means of a buffer stock. The dismal history of previous attempts to regulate mineral markets through formal intergovernmental arrangements demonstrates to officials the difficulties inherent in trying to negotiate and operate a successful regulatory scheme, while the extreme and conflicting demands of developing-exporting and developed-importing countries indicate that any measures that could likely be agreed upon would be ineffective and unworkable.

If inter-governmental collaboration is necessary to deal with extreme instability or severely depressed prices, officials believe that it should generally be designed to make markets work better, not to replace markets with inter-governmental regulation. This is one reason for Canada's traditional stance in favour of producer-consumer study groups. Because they do not impose binding obligations on their members, study groups do not threaten to introduce restrictions, distortions, and rigidity into markets. Also, the informality, confidentiality, and restricted membership of study group meetings is more conducive to frank discussion and inter-governmental co-operation than are formal meetings set in the highly politicized United Nations context. However, according to a number of officials, the most important reason for Canadian support for study groups is the opportunity that these meetings provide for informal discussions among industry leaders from many countries. Producer-consumer study groups are acceptable under US and European anti-trust laws, and therefore provide a safe and convenient forum for discussions among private firms that may be of questionable legality if held under other auspices. These private discussions do not necessarily involve price fixing and market sharing (although they certainly might), but the information exchanged about such things as production plans does enable producers to make independent decisions on the basis of much better information about their counterparts' intentions. Furthermore, the private meetings help to establish the trust, mutual understanding, and recognition of corporate interdependence that are essential if oligopolistic market management is to be workable and effective.

Mine workers and mining communities in Canada have often had to cope with unemployment resulting from production cut-backs brought on by poor international market conditions. However, these groups have rarely expressed any interest in inter-governmental action to stabilize or support mineral markets, largely because of the ability and willingness of Canadian governments to help those hurt by market fluctuations through the provision of an expensive "safety net" of social services.[157] Miners and mining communities have been conditioned by years of experience with unstable mineral markets to accept the cyclical nature of mining employment. Consequently, during the 1970s, when most of these negotiations were underway, miners tended to look to the federal and provincial governments for assistance to help them weather what were perceived as temporary downturns. Only in exceptional circumstances have such domestic groups called for direct government intervention in mineral markets, most notably in the cases of uranium, when the entire industry was threatened, and nickel, when the mining communities first began to suffer from instability in the mid-1970s. More recently, copper mining unions, suffering badly from the prolonged recession, have begun to demand government support for stockpiling. In those cases of Canadian support for collaborative inter-governmental action, concern about the impact of unstable or weak international markets on mine workers and their communities was clearly a major influence, even though these groups were not directly involved in consultations with policy-makers.

Canadian policy towards collaborative inter-governmental efforts to manage mineral markets is also influenced by considerations arising out of the wider political and economic environment in which that policy is made. Domestically, responsibility for mineral policy in Canada is divided between the federal and provincial governments, and this has led to considerable conflict between the two levels. The provincial claim for a share of jurisdiction in the area of international mineral trade arises largely out of provisions in the British North America Act regarding provincial ownership of mineral resources.[158] In practice, Canadian participation in any formal inter-governmental arrangement to regulate an international mineral market would require the co-operation of all producing and consuming provinces, and this could prove to be a formidable obstacle,[159] particularly if participation required that restrictions on production or exports be distributed among a number of provinces. Since discussions leading towards a formal ICA for a mineral exported by Canada have always stalled on other issues, the problem remains somewhat hypothetical, although it could have become very real had a copper agreement been negotiated. Conversely, exclusive federal jurisdiction over uranium production and trade and the Ontario government's support for Ottawa's actions facilitated Canadian participation in the uranium cartel. The problem of federal-provincial jurisdictions has also contributed in a minor way to the marked Canadian preference for informal study groups, which do not involve the sort of binding obligations that could give rise to federal-provincial conflicts.

Canada's status as an importer as well as an exporter of minerals also influences Canadian policy towards inter-governmental regulation of mineral markets. As a mineral importer, Canada is concerned about security of supply at reasonable prices. Officials realize that Canada must expect those countries that export to Canada to demand the same conditions that Canada seeks for its exports, and in particular, if Canada wants to be included in discussions regarding those minerals it imports, it must not exclude importers from discussions regarding minerals exported by Canada. This perhaps explains Canada's reluctance to become involved in producer-only associations or cartels although, as the government's policy on uranium makes clear, such action has not been ruled out.

The opposition of Canada's OECD partners to mineral market regulation, and in particular to cartels, is another extrinsic influence on Canadian policy towards mineral market regulation. The hostile reaction of many in the United States to Canada's participation in the uranium cartel emphasized the diplomatic problems that can arise when Canada participates in action to drive up the prices of minerals exported to other western industrialized countries. The United States has been able to influence Canadian policy by asserting the extra-territorial jurisdiction of US anti-trust laws to firms with operations in both Canada and the United States. The threat of prosecution under US anti-trust law made Gulf reluctant to participate in the uranium cartel and made Inco wary of supporting the INDC proposals. The extra-territorial reach of US anti-trust law therefore impeded--although in the end it did not block--the Canadian government's ability to implement policies intended to help the Canadian industry. The scope for retaliation by consuming countries against Canadian policies that affect them adversely is also very wide, both with respect to the affected exports themselves and to unrelated sectors. Finally, Canadian officials believe that inter-governmental collaborative action cannot succeed in the face of opposition from major producers or consumers. Since the major consumers of virtually all minerals and the major producers of many minerals are Western developed countries, it follows that Canadian officials will want them to be involved in any inter-governmental action.

Mention should also be made of two other non-sector-specific considerations that one might have expected would influence Canadian policy, but which did not in fact do so. As discussed in the introduction, despite the dependence of many regional economies in Canada on mineral production for export, none of the minerals considered in this study alone accounts for more than a very minor proportion of total Canadian export earnings. Fluctuations in export earnings for individual minerals have only a marginal impact on the overall Canadian balance of payments. The diversity of the Canadian economy therefore means that the Canadian government does not feel any need for inter-governmental mineral market regulation to support and stabilize Canada's overall export earnings. This stands in stark contrast to the situation in many developing countries that do depend on particular minerals for substantial portions of their export earnings.

The other consideration that has had no substantive influence on Canadian policy, despite innumerable public statements by Prime Minister Trudeau and other Canadian leaders that might indicate otherwise, is the needs and aspirations of Third World mineral exporters. Prime Minister Trudeau and certain cabinet colleagues who shared his interest in international economic development were initially inclined to favour a positive Canadian response to the Third World's demands for the reform of international commodity trade. They also felt that Canada, as a major commodity producer and exporter, shared common interests with developing countries in commodity trade regulation. These politicians therefore saw commodity trade negotiations as an area in which Canada might take the initiative in North-South relations. Most officials, of course, took quite a different view and were under considerable pressure from cabinet to adopt a more forthcoming stance, particularly in the copper negotiations. However, officials strongly believed that Canada's interests lay in open, competitive mineral markets. For all of the reasons outlined above, they felt that inter-governmental regulation, especially as proposed by developing countries, would have serious negative consequences for Canada. As one senior official expressed the prevailing view in the bureaucracy, "quite frankly, we just have too much at stake in this area" to use it as the basis for a North-South diplomatic initiative.

Cabinet's dissatisfaction with the advice of the bureaucracy and the latter's resistance to directions from ministers prompted Cabinet in the fall of 1978 to order a major inter-departmental review of Canadian policy towards commodity trade agreements.[160] Not surprisingly, when the review was presented to the Clark Cabinet one year later, it came out in defence of the views of those officials who prepared it. Ultimately, officials were able to convince both the Clark and Trudeau Cabinets that Canada's interests lay in open rather than regulated commodity markets, and that Canada had too much at stake in commodity trade to play around with inter-governmental regulation in the interests of North-South diplomacy. Pressure from cabinet, as well as from officials concerned with Canada's relations with developing countries, did help to moderate the rhetoric of Canadian negotiators, but had no perceptible influence on the concrete positions adopted by Canada with respect to developing countries' proposals for the regulation of mineral markets.

These conclusions lead us to some closing comments on the prospects for Canadian policy. While conditions in the markets for most of these minerals have been depressed for some time and are not likely to improve to pre-recession levels in the near future, the prospects for inter-governmental collaboration to ameliorate market problems are not good. There may be a role for the federal government to play in fostering international deliberations and co-operation to deal with mineral market problems, particularly in light of the breakdown of private market management systems and the possibility that inter-governmental consultations could help to convince government-controlled producers in developing countries to be more responsive to market forces. Bodies like the ILZSG hold the greatest promise because of their flexible, informal approach involving consumers as well as producers and because they hold out the possibility of evolution in the direction of more explicit agreements if required.

However, the government's experience with the negotiations for nickel and copper study groups also demonstrates the difficulties involved in trying to generate a useful international dialogue. Certain developing-producing countries tend to demand formal inter-governmental market regulation and tend also to be reluctant to accept anything less, while the major developed consuming countries are extremely reluctant to support inter-governmental collaboration, especially in light of the advantages for consumers of the over-supply and low prices that prevailed in most mineral markets in the early 1980s. Even private Canadian producers, who might benefit from some forms of inter-governmental co-operation, are extremely resistant to virtually any form of government intervention in international markets.

Given these conflicting positions, there is little that Ottawa can do other than wait for demand to increase in the major consuming countries, while supporting unemployed miners and their communities with unemployment insurance and other social services. The problems faced by the Canadian mining industry since the late 1970s are essentially unavoidable, given the structural position of that industry as a profit-motivated supplier to international markets where conditions are beyond Canadian control. Furthermore, the marginal international importance of Canadian mineral production at a time of substantial international over-capacity and the marginal importance of Canada in other sectors of international economic relations mean that the Canadian government is unable to generate international support for measures, however innocuous that might help its mineral industries.

Acknowledgements

Much of this paper is based on interviews with government officials and industry spokesmen.

Notes

1. Figures from United Nations, 1980 Yearbook of International Trade Statistics, Volume I: Trade by Country (New York: United Nations, 1981).
2. Department of Energy, Mines and Resources, Canada, Mineral Policy: A Discussion Paper (Ottawa: EMR, 1981), 9; and Department of Energy, Mines and Resources, Canada, Statistical Summary, "Canada, General Economic Indicators, 1966-80", in Canadian Minerals Yearbook 1980, Minerals Branch Mineral Report 30, (Ottawa: Supply and Services Canada, 1983).
3. EMR, Mineral Policy, 12.
4. Jean-Paul Drolet, "Resource diplomacy in a Canadian perspective", Resources Policy 4 (No. 3 1978): 192.
5. North-South Institute (NSI), Commodity Trade: Test Case for a New Economic Order (Ottawa: North-South Institute, 1978), 58;

Alexander Dow, "International minerals policy should be adopted by Canada", International Perspectives (November/December 1977): 19-25.

6. Drolet, "Resource diplomacy", 192.

7. Economic Intelligence Group, Department of Industry, Trade and Commerce, Canada, Canada's Trade Performance 1960-1977. Volume I: General Developments, (Ottawa: Economic Intelligence Group, DITC, 1978), 40; Archibald R.M. Ritter, Conflict and Coincidence of Canadian and Less Developed Country Interests in International Trade in Primary Commodities, Discussion Paper No. 109, Economic Council of Canada, (Ottawa: Supply and Services, 1978), 50.

8. Ritter, Conflict and Coincidence, 50 and 53-4.

9. Department of Energy, Mines and Resources, Canada, "Towards a Mineral Policy for Canada: Opportunities for Choice", (Ottawa: EMR, 1974), 17.

10. Calculated from "Table 5: Statistical Summary", EMR Canadian Minerals Yearbook 1980.

11. Elizabeth Urquhart, The Canadian Nonferrous Metals Industry: An Industrial Organization Study, (Kingston: Centre for Resource Studies, Queen's University, 1978), 122. For a good discussion of the reasons for this instability, see H. Labib and A.R.M. Ritter, "Stabilizing the International Copper Market: The Viability and Impacts of Alternate Market Management Arrangements", Canadian Journal of Development Studies 2 (No. 1 1981): 70-115, at 74-6.

12. Karen A. Mingst, "Cooperation or illusion: an examination of the intergovernmental council of copper exporting countries", International Organization 30 (No. 2 1976): 263-87, at 280-1.

13. Raymond F. Mikesell, The World Copper Industry: Structure and Economic Analysis, (Baltimore: Johns Hopkins University Press for Resources for the Future, 1979), 105-6.

14. NSI, Commodity Trade, 83.

15. Mikesell, World Copper Industry, 106; Interviews with government officials.

16. Department of Energy, Mines and Resources, Canada, Mineral Resources Branch, "Copper", Mineral Policy Series, Mineral Policy Bulletin MR 149, (Ottawa: Supply and Services Canada, 1976), 35.
17. When one senior official attended a CIPEC meeting at the time of the IPC talks, the government was immediately questioned about its intentions by alarmed Canadian producers, whose customers were very nervous at this time of much talk of resource cartels.
18. Garth Stevenson, "The Process of Making Mineral Resource Policy in Canada" in Natural Resources in US-Canadian Relations. Volume I: The Evolution of Policies and Issues, edited by Carl E. Beigie and Alfred O. Hero Jr., pp. 167-201, (Boulder, Colorado: Westview Press, 1980), at 186.
19. Department of Energy, Mines and Resources, Canada, Mineral Policy Division, "Canadian Minerals and International Economic Interdependence", Mineral Policy Series, Mineral Bulletin MR 162 (Ottawa: Supply and Services Canada, 1977), 15.
20. See UNCTAD document series TD/B/IPC/COPPER/ for records of these meetings.
21. Mikesell, World Copper Industry, 111-2.
22. Urquhart, Canadian Nonferrous Metals, 112, 118, 120; Mikesell, World Copper Industry, 88-9. For good explanations of oligopoly and how producer pricing systems based on price leadership operate, see Urquhart, Canadian Nonferrous Metals, 111-2, and Frederic M. Scherer, Industrial Market Structure and Economic Performance, (Chicago: Rand McNally College Publishing Company, 1980).
23. Urquhart, Canadian Nonferrous Metals, 122.
24. Ibid., 120-1; EMR, Canadian Minerals Yearbook 1980, 150. Canadian producers have better access to the US market than other foreign producers because of lower transportation costs, Canada's reputation as a secure, reliable supplier, and the close business and cultural links between the two countries. See Urquhart, Canadian Nonferrous Metals, 21-2; Richard Shaffner,

"The Resource Sectors of the United States and Canada: An Overview" in Beigie and Hero, Volume I, pp. 13-65, at 17; Jacob Kaplan, "US Resource Policy: Canadian Connections" in Beigie and Hero, Volume I, pp. 103-124, at 112-3 and 118-9. The copper concentrate producers in British Columbia have not benefitted from North American price stability, since they sell nearly all of their production to Japan at prices determined on the LME (Urquhart, Canadian Nonferrous Metals, 22), but many do have some degree of protection from market instability by virtue of low costs of production and/or long-term marketing arrangements with Japanese smelters.

25. Urquhart, Canadian Nonferrous Metals, 153; Mikesell, World Copper Industry, 28 and 31; World Bank, Commodities and Export Projections Division, Economic Analysis and Projections Department, Copper Handbook, (February 1981) Volume III, 1 and 3.
26. Mikesell, World Copper Industry, 112 and 366.
27. World Bank, Copper Handbook, V-1.
28. Globe and Mail, 19 May 1983, p. B2.
29. W.J. Barbour, "Background Paper Submitted by Noranda Mines Limited", reprinted in The Canadian Perspective on Commodities: Collected Papers, (Ottawa: The Canadian Group of the Trilateral Commission, 1978), 4. Department of Energy, Mines and Resources, Canada, Mineral Policy Sector, "The Canadian Nonferrous Minerals Industries to 1985", Internal Report, MRI 80/14 (Ottawa: Supply and Services Canada, 1980), 12.
30. EMR, Mineral Policy, 150.
31. The UNCTAD Secretariat suggested in an early document that export restrictions should be allocated in a discriminatory manner to favour developing countries; Labib and Ritter, "Stabilizing the Copper Market", 86.
32. EMR, "Canadian Nonferrous Minerals to 1985", 12.
33. NSI, Commodity Trade, 58 and 60.

34. Many industry executives appear to believe that an ICA would require a high degree of government involvement in the day-to-day operations of private firms, and that this close regulation might be a prelude to nationalization; Interviews with industry spokesmen.
35. NSI, Commodity Trade, 85.
36. Barbour, "Background Paper Noranda Mines", 14.
37. Some officials interviewed pointed to industry opposition as the crucial factor in the Canadian government's position.
38. Barbour, "Background Paper Noranda Mines", 10.
39. There was brief interruption during the commodity price boom of the mid-1970s; World Bank, Commodities and Export Projections Division, Economic Analysis and Projections Department, Commodity Trade and Price Trends, 1983/84 (Washington, D.C.: World Bank, 1983), 126-7; Carmine Nappi, Commodity Market Controls: A Historical Review, (Lexington, Mass.: Lexington Books, 1979), 149.
40. United Nations document TD/B/C.1/125, 5.
41. Jean-Luc Pepin, "Canada's Trade with Developing Countries", Address by the Minister of Industry, Trade and Commerce at the University of Windsor, 6 November 1970, Statements and Speeches 70/16 (Ottawa: Information Division, Department of External Affairs), 8.
42. Department of Energy, Mines and Resources, Canada, Mineral Resources Branch, "Iron Ore", Mineral Policy Series, Mineral Bulletin MR 148, (Ottawa: Supply and Services Canada, 1976), 21.
43. Ibid., 28.
44. Nappi, Commodity Market Controls, 148.
45. Christopher P. Brown, The Political and Social Economy of Commodity Control (London: Macmillan, 1980), 205.
46. William T. Hogan, "Iron Ore" in Natural Resources in US-Canadian Relations, Volume II: Patterns and Trends in Resource Supplies and Policies edited by Carl E. Beigie and Alfred O. Hero Jr., pp. 5-43 (Boulder, Colorado: Westview Press,

1980), at 12-13, 28 and 37-41. Also see EMR, "Iron Ore", 16 and 29.

47. EMR, "Iron Ore", 20-1.

48. *Ibid.*, 14, 21 and 23-4.

49. *Ibid.*, 21.

50. In 1976, EMR calculated that 77.1 per cent of Canadian iron ore production capacity was US owned. EMR, "Iron Ore", 4.

51. EMR, *Canadian Minerals Yearbook 1980*, 228; EMR, "Iron Ore", 10.

52. Department of Energy, Mines and Resources, Canada, Mineral Policy Sector, "Industry-Government Relations, Mineral Issues and Policy Framework: A Background Paper", Internal Report prepared by W.G. Jeffery, MRI 81/1 (Ottawa: EMR, 1981), 15.

53. In 1980, exports accounted for 77 per cent of total production of 50.9 million metric tonnes and were valued at $1.24 billion. Iron ore imports accounted for 35 per cent of domestic consumption of 16.6 million metric tonnes and were valued at $270 million; EMR, *Canadian Minerals Yearbook 1980*, 228-9.

54. Raymond F. Mikesell, *International Collusive Action in World Markets for Nonfuel Minerals: Market Structure and Methods of Marketing Control*, External Research Study, 25 July 1974, (Washington: US Department of State, Bureau of Intelligence and Research, 1974), 20.

55. EMR, *Mineral Policy*, 150-2.

56. Lead and zinc will be dealt with together because they are usually produced in conjunction with one another and because there exists one inter-governmental organization for both minerals.

57. Department of Energy, Mines and Resources, Canada, Mineral Resources Branch, "Zinc", Mineral Policy Series, Mineral Bulletin MR 159, (Ottawa: Supply and Services Canada, 1976), 40. Also see International Lead and Zinc Study Group Paper, January 1979, (London: International Lead and Zinc Study Group, 1979), mimeo.

58. EMR, "Zinc", 40-1; Donald J. Patton, "The Evolution of Canadian Federal Mineral Policies" in Beigie and Hero, Volume I, 203-46 at 223.
59. EMR, "Zinc", 48; "Federal Government Contribution" in The Canadian Perspective on Commodities, 20.
60. Scherer, Industrial Market Structure, 162-3, 168 and 224.
61. Patton, "Evolution of Canadian Mineral Polcies", 223.
62. United Nations document TD/B/4, February 1965.
63. World Bank, Commodity Trade and Price Trends, 1983/84, 24.
64. EMR, "Zinc", 39.
65. Harold F. Fargey of Cominco, quoted in A Balance Sheet of Third World/Canada Relations: Report and Issue-Papers, by the North-South Institute for the International Foundation for Development Alternatives (Ottawa: NSI, 1979), 14.
66. "Federal Government Contribution", 20; Patton, "Evolution of Canadian Mineral Policies", 223.
67. For industry views which cover some of these points, see H.T. Fargey, "Submission by Cominco Ltd." in The Canadian Perspective on Commodities, 5; Kenneth H.J. Clarke, "Notes for Discussion of Price and Earnings Stabilization" in The Canadian Perspective on Commodities, 11.
68. Urquhart, Canadian Nonferrous Metals, 130 and 137.
69. EMR, "Canadian Nonferrous Minerals to 1985", 4. The recession of the early 1980s severely depressed lead prices in both current and real terms, as it has done to the prices of most minerals.
70. Department of Energy, Mines and Resources, Canada, Mineral Policy Sector, "A Review of the World and Canadian Zinc Industry", Internal Report, MRI 80/12, June 1980 (Ottawa: EMR, 1980), 9.
71. Ibid., 7; Urquhart, Canadian Nonferrous Metals, 112-3, 127, and 133; Department of Energy, Mines and Resources, Canada, Mineral Policy Sector, "A Review of the World and Canadian Lead Industry", Internal Report prepared by G.R. Peeling, MRI 80/15, July 1980 (Ottawa: EMR, 1980), 10. The producer price system for zinc may also be supplemented by direct

collaboration among producers in the Zinc Institute, an organization of producing companies "which has long been suspected of providing a forum at which price fixing. . .may take place." June H. Taylor and Michael D. Yokell, Yellowcake: The International Uranium Cartel (New York: Pergammon Press, 1979), 98.

72. Urquhart, Canadian Nonferrous Metals, 130, 132, and 137; EMR, "Review of World Lead Industry", 16. EMR, "Review of World Zinc Industry", 9 and 11.

73. See EMR, Canadian Minerals Yearbook 1980, 258 and 538, for the relative importance of the different export markets. Canadian producers have good access to US lead and zinc markets for the same reasons as Canadian copper producers vis-à-vis US copper markets. See note 24.

74. Urquhart, Canadian Nonferrous Metals, 128 and 135.

75. Scherer, Industrial Market Structure, 241.

76. Urquhart, Canadian Nonferrous Metals, 114. See also p. 5 in the same work.

77. John I. Cameron, "Nickel", in Beigie and Hero, Volume II, pp. 45-92, at 59. Inco's moderate pricing behavior has been explained by its adoption of a cost-plus rather than profit-maximizing method of price determination, and its desire to avoid high prices which would stimulate the entry of new producers, encourage consumers to switch to substitutes, and increase the likelihood of investigation by US anti-trust authorities. See Cameron, "Nickel", 60 and 79; Scherer, Industrial Market Structure, 241; Department of Energy, Mines and Resources, Canada, Mineral Resources Branch, "Nickel", Mineral Policy Series, Mineral Bulletin MR 157 (Ottawa: Supply and Services Canada, 1976), 17.

78. World Bank, Commodity Trade and Price Trends, 1983/43, 130-1.

79. The US, Japanese and French governments aided the growth of competition by providing incentives for their own nickel-producing companies at home and abroad. Cameron, "Nickel", 45, 46, and 85-6; Urquhart, Canadian Nonferrous

Metals, 5 and 153.

80. EMR, "Nickel", 47.
81. Ibid., 17; Urquhart, Canadian Nonferrous Metals, 115; Cameron, "Nickel", 59.
82. Urquhart, Canadian Nonferrous Metals, 118. Inco was still following a policy of not dropping its posted prices when demand slumped.
83. Confidential cable from the US embassy in Canberra to the State Department, cited in Earle Gray, The Great Uranium Cartel, (Toronto: McClelland and Stewart, 1982), 100-1.
84. EMR, "Nickel", 46.
85. EMR, "Canadian Nonferrous Minerals to 1985", 4.
86. Robert D. Cairns, "A Reconsideration of Ontario Nickel Policy", Canadian Public Policy 7 (No. 4 1981): 526-33 at 527.
87. Urquhart, Canadian Nonferrous Metals, 114-5, 118 and 153 for details.
88. Cairns, "Reconsideration of Ontario Nickel", 528.
89. Ibid., 527 and 530.
90. Cameron, "Nickel", 62.
91. Ibid., 78.
92. "Nickel cartel studied as a way to raise prices", Globe and Mail, 22 October 1977, p. B2.
93. Inco statement quoted in Globe and Mail, 25 October 1977, p. B16.
94. However, in the mid-1970s the nickel industry was prepared to consider an ICA to deal with the threat from seabed mining. William E. Haviland, "Commodity Price and Earnings Stabilization: Synthesis Paper" in The Canadian Perspective on Commodities, 5.
95. A.J. Webb, "Canada's non-fuel mineral trade and the international mineral scene", Canadian Mining Journal 100 (No. 2 1979), 50.
96. Walter Curlook (Executive Vice-President, Inco Ltd.), "Nickel: Situation and Outlook", Paper presented to the Canadian Mineral Outlook Conference, Ottawa 17-18 May 1983, mimeo, 4-5.

97. Ibid., 5 and 8.

98. Ibid., 1-4; Cairns, "Reconsideration of Ontario Nickel", 527.

99. EMR, Canadian Minerals Yearbook 1980, 313 and 316-7.

100. Globe and Mail, 10 February 1978, pp. 1-2; and 18 September 1982, p. B16.

101. Some officials felt that the private Canadian producers had not given them sufficient information or warning of the impending troubles.

102. Gray, Great Uranium Cartel, 52; J.W. Griffith, The Uranium Industry, Its History, Technology and Prospects, Mineral Report 12, (Ottawa: Mineral Resources Division, EMR, 1967), 11.

103. 90 per cent of Canadian uranium exports into the early 1960s went to the United States; Griffith, Uranium Industry, xi, 21 and 54; Gray, Great Uranium Cartel, 52-3.

104. Marian Radetzki, Uranium: A Strategic Source of Energy (London: Croom Helm Ltd., 1981), 44.

105. Gray, Great Uranium Cartel, 58-9, 64-5; Griffith, Uranium Industry, 13; Radetski, Uranium, 43-4.

106. Gray, Great Uranium Cartel, 77-8; Ted Greenwood with Alvin Streeter Jr., "Uranium", in Beigie and Hero, Volume II, 319-95 at 346-7; Radetski, Uranium, 45; Hugh C. McIntyre, Uranium, Nuclear Power, and Canada-US Energy Relations, (Montreal: Canadian-American Committee, 1978), 15.

107. Radetski, Uranium, 45; Gray, Great Uranium Cartel, 68-9; Griffith, Uranium Industry, iii and 82-3.

108. Gray, Great Uranium Cartel, 80-6; Radetski, Uranium, 44.

109. Gray, Great Uranium Cartel, 97; Alastair Gillespie, Minister of Energy, Mines and Resources, "Background Paper on the Canadian Uranium Industry's Activities in International Uranium Marketing", Ottawa, 22 September 1976, reprinted in International Uranium Supply and Demand, Hearings Before the US Subcommittee on Oversight and Investigations, of the Committee on Interstate and Foreign Commerce, 94th Congress, Second Session, 4 November 1976. (Washington, D.C.: US Government Printing Office, 1977), 13-5.

110. Radetski, Uranium, 45-6; Gray, Great Uranium Cartel, 95-6; Griffith, Uranium Industry, 14 and 22.

111. Gray, Great Uranium Cartel, 95-6.

112. Ibid., 97-9; McIntyre, Uranium and Energy Relations, 15.

113. Gray, Great Uranium Cartel, 102-4; Larry R. Stewart, "Canada's role in the international uranium cartel", International Organization 35 (No. 4 1981): 657-89 at 662.

114. Alastair Gillespie, Minister of Energy, Mines and Resources, "Statement on the Canadian Uranium Industry's Activities in International Uranium Marketing", Ottawa, 22 September 1976, in International Uranium Supply and Demand, 12-3.

115. Gray, Great Uranium Cartel, 106 and 119-20; Stewart, "Canada's role in cartel", 662-3.

116. "Confidential Report of the Discussions in Paris on the Uranium Industry, 1-4 February 1972" in International Uranium Supply and Demand, 351.

117. Radetski, Uranium, 17-19 and 109-11.

118. Ibid., 112.

119. Ibid., 113.

120. See Gray, Great Uranium Cartel, Chapter 8, and documents (many marked "confidential" or "secret") contained in International Uranium Supply and Demand, and International Uranium Cartel, Volumes I and II, for fascinating accounts of these meetings.

121. See documents containing text of agreement reached at Johannesburg, 29 May-2 June 1972, in International Uranium Supply and Demand, 184-95.

122. See note 120.

123. Stewart, "Canada's role in cartel", 682-3.

124. Cartel meetings were reported in trade journals and major newspapers; Stewart, "Canada's role in cartel", 675; Gray, Great Uranium Cartel, 101-2, 145 and 160-3.

125. Gray, Great Uranium Cartel, 105-6 and 161, for details of communications between Canada and the United States.

126. Uranerz received "unofficial approval" from the West German government for its participation in the cartel meetings; O.J.C. Runnalls, "Memorandum: Meeting of Canadian Uranium Producers, May 9" in International Uranium Cartel, Volume I, 535. See Taylor and Yokell, Yellowcake, 72, on the close ties between RTZ and the British government. Another interesting indication of the Canadian government's indifference regarding consumer/government knowledge of the cartel came when Uranerz and Gulf announced their intention to get anti-trust clearance from the West German government and the anti-trust authorities in the US Department of Justice. Canadian officials objected to both actions, but only on the grounds that they implied the extra-territorial jurisdiction of West German and US laws to corporations operating in Canada. There was no objection to informing these foreign authorities about the existence of the cartel. See, for example, R.K. Allen, "File Note: Canadian Uranium Producers' Meeting, Ottawa, April 10, 1972" in International Uranium Cartel, Volume I, 475.
127. Stewart, "Canada's role in cartel", 684-7.
128. Radetski, Uranium, 25.
129. Gray, Great Uranium Cartel, 164-76; Taylor and Yokell, Yellowcake, 114-23; Radetski, Uranium, 81-94, 125 and 129; Paul L. Joskow, "Commercial Impossibility, the Uranium Market and the Westinghouse Case" (1977), 6 J. of Legal Studies 119. Nuclear Exchange Corporation, "Significant Events in the Uranium Market 1969-1976", 15 October 1976 in International Uranium Supply and Demand, 363-74.
130. Gray, Great Uranium Cartel, 150-3; Greenwood, "Uranium", 347-8.
131. Radetski, Uranium, 117 and 108.
132. Taylor and Yokell, Yellowcake, 89 and 157; Radetski, Uranium, 27-8.
133. See "Draft Minutes of the 9th Operating Committee Held in Las Palmas on November 23, 1973", 5 December 1973 in International Uranium Supply and Demand, 254, and "Draft No.

3: The Uranium Institute: Constitution", 30 January 1974 in International Uranium Supply and Demand, 265, for indications of the initial intentions of the cartel members. Also, see EMR, "Canadian Minerals and Interdependence", 16-7, for the objectives of the Institute as actually constituted.

134. Taylor and Yokell, Yellowcake, 98.

135. Radetski, Uranium, 118 and 120-1; Ian Montgomerie, "The Best of Intentions: Canadian Uranium Export Policy in the Seventies", M.A. Thesis, University of Alberta, 1982, 72-3.

136. Radetski, Uranium, 118.

137. Ibid., 17; McIntyre, Uranium and Energy Relations, 47-9. See also the sources cited in note 129.

138. Taylor and Yokell, Yellowcake, 198.

139. The US market was to have been excluded from the cartel arrangements. According to a Gulf file memo written by F.R. O'Hara and dated 15 October 1973, "The Canadian government has changed its position and stated that it will not approve exports of Canadian uranium into the United States at less than group prices." See International Uranium Cartel, Volume II, 113. Following this change in policy, Rio Algom was forced by the AECB (which implemented cabinet decisions on uranium exports) in early 1974 to raise the price at which it was offering to sell uranium to a major US utility to the cartel price; D.J. Lecraw, "The Uranium Cartel: An Interim Report", The Business Quarterly 42 (No. 4 1977): 76-84 at 80.

140. Greenwood, "Uranium", 351-2.

141. EMR, Canadian Minerals Yearbook 1980, op. cit., 520.

142. Ibid., 527-8 and 535.

143. Greenwood, "Uranium", 379; McIntyre, Uranium and Energy Relations, 18 and 51.

144. Donald MacDonald, then Minister of EMR, made a number of speeches in these communities during the period of the formation of the cartel. He emphasized "the Federal government's concern for the stability of resource communities" and noted that "the Government of Canada has taken steps for

the holding of discussions at an international level regarding the state of the uranium industry and of the development of nuclear programmes." Donald A. MacDonald, public statement at Elliot Lake, Ontario, 21 April 1972, quoted in Roy D. Jackson, "Opinion Memorandum for Gulf Minerals Canada Ltd." 8 September 1972 in International Uranium Cartel, Volume II, 200. One commentator credited the defence of the uranium industry for an increase in electoral support for the Liberals in Northern Ontario; Stewart, "Canada's role in cartel", 679.

145. Stewart, "Canada's role in cartel", 671.

146. Stevenson, "Process of Making Mineral Policy", 171-2; Greenwood, "Uranium", 345.

147. Roff Johansson, "Nuclear Exports and Canadian Foreign Policy", unpublished manuscript 1981, Chapter IV, 39.

148. Stewart, "Canada's role in cartel", 661-2.

149. Stewart makes a similar point in ibid., 688.

150. Ibid., 675-6. At one meeting of Canadian uranium producers, Jack Austin referred to newspaper accounts of uranium producers' activities and said that he "felt there was no need for the Government of Canada or anyone else for that matter to say anything further on the subject to reporters." O.J.C. Runnalls, Memorandum to Mr. J. Austin, "Minutes of Canadian Uranium Producers Meeting, September 5, 1972" in International Uranium Cartel, Volume I, 593.

151. Stewart, "Canada's role in cartel", 676-7.

152. This section of the conclusions is drawn in large part from Michael Webb and Mark Zacher, "Alloyed with the Industrialists: Canadian Mineral Industries and Canadian Policy", in Domestic Groups and Canadian Foreign Policy Making, edited by Don Munton, forthcoming.

153. Shaffner, "Resource Sectors", 17; Kaplan, "US Resource Policy", 112-3 and 118-9; Urquhart, Canadian Nonferrous Metals, 21-2.

154. NSI, Commodity Trade, 85.

155. G.J.S. Govett and M.H. Govett, "A Canadian Perspective on Commodities" in The Canadian Perspective on Commodities, 11.

Indirect government support such as government-financed infrastructure developments and tax incentives have of course not been opposed or refused. Stevenson, "Process of Making Mineral Policy", 189.

156. See sources cited in Webb and Zacher, "Alloyed with the Industrialists".

157. Judy Erola, Minister of State (Mines), "Notes for an Address to the Annual Meeting of the Mining Association of Canada", Canadian Mineral Outlook Conference, Ottawa 17-18 May 1983, mimeo, 6.

158. Marsha A. Chandler and William M. Chandler, Public Policy and Provincial Politics (Toronto: McGraw-Hill Ryerson, 1979), 253-63; Stevenson, "Process of Making Mineral Policy", 167-72.

159. Stevenson, "Process of Making Mineral Policy", 172-3.

160. North-South Institute, In the Canadian Interest? Third World Development in the 1980s (Ottawa: NSI, 1980), 65.

7: THE WEST'S DEPENDENCE ON IMPORTED STRATEGIC MINERALS: IMPLICATIONS FOR CANADA

David G. Haglund

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THE WEST'S DEPENDENCE ON IMPORTED STRATEGIC MINERALS: IMPLICATIONS FOR CANADA

Introduction

For most of the past decade, the major industrialized members of the Western economic and military community have been evincing concern about the security of their raw-material supply, in particular their supply of "strategic minerals." Access to minerals is not a new issue among industrialized states; even at the end of World War One, policy-makers were acutely conscious of the role played by minerals in the calculation of the military potential of nations. Indeed, during the inter-war period it seemed to many--nowhere more so than in the "have-not" countries of Germany, Japan and Italy--that the "great lesson" of World War One was that access to mineral supply had meant the difference between victory and defeat for the Central Powers.[1] Although the outbreak of World War Two can be explained in a number of ways, one constituent part of the collapse of world order in the 1930s was certainly this assumption which was widely held by states bent on challenging the post-World War One status quo: that the global "maldistribution" of raw materials doomed them to a perpetual second-class standing in world power politics.[2]

The period after World War Two has witnessed a diminution in the direct relevance of minerals to a nation's military potential, but at the same time there has been a heightened appreciation of the relationship between assured mineral supply at stable prices and the overall functioning of the international economy. Thus, some analysts of the early post-war decades expected that minerals and other natural resources would be less significant than they had been in the past, mainly because of advances in the technology of warfare; such an assumption has been rendered nugatory by the increased importance of minerals to the well-being of an industrialized state's economy.[3] Put differently, in the past ten years or so there has been a broader understanding of the concept of "strategic minerals"; at the same time, there was a growing recognition that the economic dimension of security is nearly as important as, and occasionally indistinguishable from, a state's physical security. As a recent White House report notes, "the United States and its allies are heavily reliant on imports of certain critical raw and processed materials. Thus a long-term supply interruption could have serious consequences for US and allied security by disrupting capabilities to produce military and essential civilian goods either in a declared national emergency or wartime mobilization."[4]

The word "critical", and not the often-employed adjective "strategic", is used here to modify materials. There is a long-standing practice in the United States, dating to a 1944 decision by the Army and Navy Munitions Board, to treat the two words synonymously.[5] Not all analysts of the mineral-access issue would agree that they are identical. For example, the British Institute of Geological Sciences has adopted the position that while "critical" is a label worth retaining, "strategic" is so bereft of meaning that, in the words of one of the Institute's researchers, "it is to be hoped that the term 'strategic minerals' falls into disuse."[6] Even if one does not incline towards abolitionism, there is still a case to be made for restricting the usage of "strategic minerals" to the greatest extent possible, say to a half-dozen or so items, like chromium, manganese, cobalt, and the platinum-group metals.[7] The problem with the restrictionist argument is that it is virtually impossible in practice to achieve a consensus on what should and should not be labelled "strategic," especially as analysis proceeds from the national to the international level.

In contrast to the abolitionists and restrictionists, there are the broad-interpretationists, who claim there are many strategic minerals which are, in the language of the drafters of current American stockpile legislation, materials that "(A) would be needed to supply the military, industrial, and essential civilian needs of the United States during a national emergency, and (B) are not found or produced in the United States in sufficient quantities to meet such need."[8] To the broad-interpretationists, strategic minerals include by definition all those minerals held in the US strategic stockpile, plus some of the essential and imported items that are not stockpiled, such as iron ore, phosphate, gallium, germanium, and molybdenum to name but a few.[9]

The restrictionists' argument makes a certain amount of sense from a policy perspective, in that the proliferation of strategic minerals fosters the feeling that minerals access is universally threatened. This, in turn, implies that strategic-minerals policies adopted by industrialized consumers must be more comprehensive (and costly) than most countries can reasonably afford. Thus if one wishes to devise relatively cost-effective ways to address the problem of guaranteeing access to vitally needed industrial inputs, preferably at stable prices, it is clearly in one's interest (if cost is the sole criterion) to minimize the number of problematic or "strategic" minerals. This is especially true if one belongs, as so many of the restrictionists do, to the analytical group who argue that "vulnerability" is a defining characteristic of strategic minerals.[10]

The habit of ascribing "vulnerability" to minerals, however, overlooks a basic fact concerning the international politics of strategic minerals: namely, that if by vulnerable we accept the common connotation that someone or something is open to attack or damage, then it is countries (not ores or metals) that are "vulnerable". But if the restrictionists are wrong in assuming that minerals rather than states are vulnerable, they are at least correct in recognizing that vulnerability is, after all, the primary minerals issue insofar as the industrialized, consuming countries are concerned (i.e., the industrialized net importers of minerals, not net exporters such as Canada or Australia). Import dependence is a necessary condition of vulnerability, but it is far from a sufficient one. Other conditions that determine whether an assessment of vulnerability is warranted include:

- the concentration of the mineral in question
- the identity of supplying countries
- whether there are alternative supply prospects (including domestic alternatives)
- the opportunities for substitution
- the intended uses of the mineral
- the opportunities for recycling and conservation, and
- the presence of stockpiles in consuming countries.[11]

Another problem with the restrictionists' argument is that their association of vulnerability with minerals not countries does not address the real problem. For example, if vulnerability is not associated with all minerals, as it clearly is not, then the vulnerability problem could be reduced to its proper dimensions by terming as "strategic" only those minerals that everyone would agree are problematic. Consensus could never be achieved on the minerals listed at present and is therefore unlikely for minerals that might cause concern in the future.

A far better way to construe strategic minerals, in my view, is to require that they merely fulfil two admittedly subjective conditions: first, that they are essential to national defence (either in the narrow military sense or the wider understanding that equates national security with economic well-being); and second, that they be traded to a significant degree internationally.[12] The second condition may surprise some analysts, especially the broad-interpretationists, who hold that import-dependence is necessarily a condition for determining whether a mineral is "strategic" to any country. Of course, the problem with adopting such a perspective is that it becomes logically absurd to speak of states being exporters of strategic minerals unless they are also importers of the same items (which typically they are not). Thus, although import dependence may be an interesting matter to study, it is not an indispensible condition for determining whether a mineral is "strategic".

It may be argued that such a definition exceeds the broad-interpretationists' stance, and perhaps it does. But the simple fact that a mineral is deemed strategic does not make the continuing supply of it problematic. Nickel, for example, has at various times in this century been one of the most strategic war metals, if not the most, but from the point of view of the United States, which has been largely dependent upon one country for its nickel since the 1890s, "vulnerability" has never been associated with nickel imports from Canada--at least by those who knew anything at all about mineral trade. As one American minerals expert succinctly put it during the middle of World War Two, "the possibility that Canada would sever diplomatic relations with the United States and cut off our nickel supply seems no more likely than the possibility of a revolt in northern Minnesota and the consequent cessation of the iron ore supply from that region. If either contingency arose, it is probable that the same method would be invoked to reopen the supply."[13]

Vulnerability is a condition that is contingent upon the fulfilment of several and at times subjective factors, of which import-dependence is not necessarily the most significant. Yet the fact remains that vulnerability is what the industrialized, consuming states are mindful of mitigating when they discuss strategic mineral "policy".

The Contemporary Nature of Vulnerability

Analysis of the contemporary nature of vulnerability takes two common forms. On the one hand are those analysts who think the primary problem with global mineral supply is economic, in the sense that they believe either that the world is running out of resources or that the world will be facing supply shortages in the future due to a lack of investment capital at the present time. On the other hand are analysts who assume that the basic causes of mineral-supply uncertainty are political. At its extreme, there is the "resource-war" thesis whereby political forces will determine whether the major consuming states will continue to have access to vitally needed inputs. More credible, however, is the argument that potential political instability in major producing areas (namely, southern Africa and the Persian Gulf) constitutes the principal menace to the West's supply of strategic minerals.

The argument that the world is running out of minerals has lost force, due to the recent recession and the sustained (and so far successful) assault on the Malthusian assumptions of the Club of Rome's famous study of the early 1970s, The Limits to Growth.[14] To be sure, there is nothing novel about the idea that non-renewable resources must, in a finite world, sooner or later become exhausted. Depletion--either where minerals actually run out, or where they become too expensive for the world to use--has been a theoretically interesting proposition ever since the time of Malthus and Ricardo.[15] What is at issue is how long it will take before either physical (Malthusian) or economic (Ricardian) scarcity sets in. Given the size and the persistence of the glut that has affected most commodity markets since the mid-1970s, few knowledgeable students of minerals envision the onset of even Ricardian scarcity until the next century. And all would agree that whether economic scarcity becomes manifest even then depends upon whether "the race between the cost-decreasing effects of new technology and the cost-increasing effects of depletion is won by the latter."[16]

It may still be that the future supply of minerals will be jeopardized by a lack of investment in the mining sector. This fear had a fairly wide currency in industrialized, consuming states during the middle and late 1970s, but has abated recently, perhaps because of the persistence and severity of the recession, which shifted attention from the problem of under-supply to that of over-supply. The concern that lack of investment might at some future date imperil the West's mineral supply is directly traced to the belief that the less-developed countries (LDCs), in flexing their commodity "muscles" over the past two decades and especially in proscribing the freedom of manoeuvre for multinational mineral-extraction enterprises, have put themselves in the unhappy position of being unable to develop their own resources at levels sufficiently high to sustain anticipated future world demand, and of being either unable or unwilling to attract foreign investment for resource development. This view holds that the LDCs are living off the legacy of past--and efficient--control of their mining by multinational corporations (MNCs). But eventually they will have to conduct their own exploration and development, and the fear is that for a variety of reasons, the task will prove too much for them.[17] Thus, according to some analysts, the most likely future cause of mineral-supply disruption will be the presumed current lack of investment in prospecting and exploration, something which is aggravated though not caused by the current unfavourable investment climate for minerals in general.[18]

Those who dispute the above contention note that although international investment in mineral-extraction enterprises may indeed be shifting away from LDCs, it is not being lost. It is merely being transferred to more hospitable arenas, principally, to the developed mineral producers like Canada, Australia, the United States, and--though some would challenge its inclusion--the Republic of South Africa. It is not hard to find evidence of the shift in mineral-exploration investment toward what one federal government study terms the "developed market economies" (DMEs). Over the past two decades, the LDC portion of such investment has declined significantly in relative terms, falling from 35 per cent of the total for 1961-65 to 14 per cent for 1971-75.[19] Since ore grades tend to be lower in the DMEs than in the LDCs, it is alleged that the shift in mining activity necessarily implies higher-cost production in the future. This assumption can only be sustained if it can be shown that ore grade has a determinative bearing on extraction costs, a proposition that some mineral economists believe is questionable. Whatever the relationship between ore grade and extraction costs, there is, as Phillip Crowson observes, "certainly no clear tendency for costs to be lower in less developed countries."[20]

Some economists argue that the world has had too much exploration activity in recent years, and that there are now more ore bodies awaiting development than ever before. As the case of nickel shows so well, fear of future shortage can serve as a powerful stimulus to new exploration efforts--efforts that have culminated in the expansion of a global productive capacity and, ultimately, depressed nickel prices.[21] We have seen that the argument that world resources cannot sustain future mineral demand is not sustainable; neither is the argument that insufficient investment today must rebound to the detriment of consuming countries because it is not clear that there is insufficient mineral investment.[22] It may well turn out that the current optimism about long-term mineral supply will seem as ill-considered a decade from now as the pessimism of the early 1970s seems today.[23] What can be said with some certainty, however, is that those who ponder the West's vulnerability to mineral-supply disruption resort much more to political explanations than to economic ones.

The starkest and, to some, the most appealing depiction of the threat to industrialized Western economies takes the form of the "resource-war" hypothesis.[24] Those who think there is a struggle for the world's resources under way believe that the Soviet Union has adopted a strategy that is aimed at impeding the West's flow of vital raw materials. Although there is no clear evidence of such a Soviet strategy, advocates of the resource-war hypothesis advance two motives to explain Soviet "behaviour":

- the Soviets are trying to deny resources to the West because they know this would have a crippling effect on Western economic, and ultimately, military strength; and
- the Soviets are covetous of certain raw materials because their own economy needs them, and since the USSR lacks the foreign exchange to trade for them, outright seizure becomes a real possibility.

The minerals in question are typically thought to be oil from the Persian Gulf and the steel alloys (cobalt, chromium, manganese, and vanadium), whose production is concentrated in southern Africa, as well as the platinum-group metals. Indeed, the southern African region has come to be regarded as the "Persian Gulf of minerals," or at least the "Saudi Arabia" of them.[25] Interestingly, the South African government has been one of the leading forces in the propagation of the resource-war hypothesis, in the hope of convincing Western democracies that their vital interests compel them to support, not oppose or be indifferent to, the Pretoria government's domestic and foreign policies.[26] These policies in turn are held to be the West's bulwark against Soviet aggression in all of southern Africa, which not only supplies vitally needed minerals, but also sits astride the sea lanes upon which are carried so much of the West's imported oil. Vast indeed is the importance of South Africa in the minds of those who accept the resource-war notion, for "if South Africa is lost to the West, the next steps aimed at achieving the Soviet goal of global domination could be a disruption of oil supplies to the West, attempts at Marxist takeovers in Chile, Peru, and Brazil, and the promotion of labour unrest through Communist-dominated labour unions in Australia."[27]

Despite the high drama implicit in the resource-war idea (or perhaps because of it), the attractiveness of the hypothesis has been waning recently. It never was taken very seriously in Western Europe, and even NATO analysts have been skeptical of many of its assumptions.[28] Apart from South Africa, the resource-war theme attracted the most attention in the United States, largely as a result of its dissemination by important foreign-policy lobbies such as the Committee on the Present Danger and other conservative groups.[29] Although the "resource war" was a theme in the 1980 campaign speeches of presidential candidate Ronald Reagan, the Reagan administration has shown no indication of adopting policies predicated on the belief that, in the words of one resource-war publicist, "the United States and its Free World allies are in an undeclared and, so far, bloodless 'resource war' with the Soviet Union--and are in grave danger of losing that war."[30]

The reduced plausibility of the resource-war hypothesis is in part attributable to a diminished concern in the West about mineral-access issues. To be sure, during the later part of the 1970s, and through 1980, many analysts in the West were making dire forecasts about future access to strategic minerals--oil in particular, but certain non-fuel minerals as well. For crude oil, the Iranian revolution seemed to portend such a grim energy future for import-dependent Western countries that well-respected energy experts such as Walter J. Levy could and did foresee "a series of future emergencies centering around world oil [that] will set back world progress for many, many years. And the world, as we know it now, will probably not be able to maintain its cohesion, nor be able to provide for the continued economic progress of its people against the onslaught of future oil shocks--with all that this might imply for the political stability of the West, its free institutions, and its internal and external security."[31]

Given the apparent heightening of a non-fuel mineral "crisis" at roughly the same time as the world oil situation was threatening to turn critical again, it appeared only logical to assume that non-fuel strategic minerals shared attributes that in the early 1970s had been associated primarily with oil: essentiality, as well as grave uncertainty as to future supply and price. For non-fuel minerals, an event the equivalent of the Iranian revolution took place in the summer of 1978--the Katangan rebel attacks near Kolwezi. This disrupted copper and cobalt production in Zaire for two months and set off a panic in cobalt markets, which resulted in a more than 700 per cent increase in the spot market price for cobalt, from US $6.75 a pound to $50 a pound.[32] Principally as a result of the Kolwezi (or "Shaba II") incident, analysts in the United States and other dependent Western countries began to reach hasty conclusions that their countries' dependence on non-fuel minerals was as important--and troubling--as their dependence on imported oil. Indeed, in the United States some claimed that dependence on non-fuel minerals was an even graver problem than dependence on oil; the United States might conceivably become self-sufficient again in oil, but "in many cases there are no substitutes for the [non-fuel] minerals imported from foreign sources, countries which are often unstable at best, hostile at worst."[33]

Those who equated non-fuel mineral dependence with energy dependence failed to notice the tremendous differences in magnitude between the former and the latter. In the case of the United States, net imports of non-fuel minerals amounted to $2.9 billion in 1980, compared with net energy imports of $74.9 billion. Internationally, aggregate exports of metallic ores, concentrates, and scrap accounted for slightly more than 1 per cent of total world exports in 1979, compared with a 20 per cent share of fuel exports.[34] If one of the characteristics of "strategic" minerals is that they be essential to economic well-being, then it is clear that, in value terms, oil is vastly more essential than all the non-fuel minerals together. Given the recent relaxation of concern about oil supply in the West, it is perhaps understandable that there has been a concomitant diminution of concern about oil's "analogue", the non-fuel minerals. One of the positive features of the recent recession, from the consuming states' standpoint, is that it relieved pressure (and worry) in regard to their access to minerals. Not since the Depression of the 1930s had most minerals been so abundant and, in real terms, so cheap.

The recession is only one reason for the reduced plausibility of the resource-war hypothesis. A more serious problem with the argument that the Soviets are launched upon a resource-denial strategy is that is does not stand up to close examination. In testimony before a Congressional subcommittee in the summer of 1981, Robert Legvold stated that "simply no evidence exists suggesting that Soviet leaders think in terms of strangling the West by denying it strategic non-fuel minerals in peacetime".[35] Although not in itself proof of anything, Legvold's testimony does reflect current thinking on the part of many Soviet experts as well as minerals analysts in the United States. Western Europeans and Canadians never needed to be disabused of the "resource-war" notion, for they had never accepted the hypothesis in the first place.

But if it cannot be shown that the Soviet Union is embarked on a conscious effort to deny Western industrial societies access to raw materials, it should not be concluded that the Soviet Union does not have an interest in mineral markets. It is a leading mineral producer and one, moreover, that derives a very significant proportion of its foreign exchange from mineral exports.[36] Though one of the most self-sufficient countries, it is also a significant importer of certain minerals, notably bauxite and alumina, cobalt, tin, tungsten, fluorspar, and mica.[37] To some observers, the Soviets are entering a "transitional period", in which they move from a position of self-sufficiency to one of dependency, with the implication being that they will provide increasing competition to Western countries for scarce raw materials. This argument is employed by resource-war analysts who hope to show that the Soviets need to seek abroad what they cannot produce at home.[38] Those who prefer an alternative hypothesis explain that the recent increase in Soviet mineral imports results from price differentials between Soviet (high-cost) production of certain minerals and foreign (low-cost) production, and not from the depletion of Soviet resources. Soviet mineral policy remains one of maximum feasible self-sufficiency, and the USSR remains one of the few countries capable of having and realizing such a policy objective.

Whether they "need" foreign minerals or not, the Soviets can be expected to try to avail themselves of opportunities to further their political and economic interests wherever possible, including in the sensitive southern African region, the focus of so much of recent minerals anxiety. It is conceivable, and likely, that Soviet foreign policy interests of a non-mineral nature will have an impact on mineral development in southern Africa and elsewhere, but this is not a basis for assuming that the USSR has launched a "resource war": to infer from Soviet activity in Africa the existence of a resource-denial strategy is to commit the error of mistaking correlation for cause.

If the resource-war argument is ultimately untenable, this does not mean that Western industrialized states should not concern themselves with the issue of access to strategic minerals. It is true that there has been a relaxation of concern about access in the past two years, but there nevertheless exist compelling reasons for industrialized importers to remain attentive to developments that might affect their supply of minerals.

The most likely cause of future supply disruptions of strategic minerals is political upheaval in important producing countries of southern Africa. Indeed, it is all but universally assumed by minerals analysts that southern Africa is the single most problematical supply source for Western industrialized economies. To be sure, the resource-war advocates have emphasized the potential volatility of southern Africa, but their analysis assumes Soviet malevolence to be the factor that destabilizes the region and jeopardizes production. One can reject the resource-war hypothesis yet still argue that southern Africa is, for a multitude of reasons, so potentially unstable that even without Soviet involvement, access to the region's minerals would be unreliable.

To a significant degree, the West's vulnerability in non-fuel strategic minerals is tied to the stability of southern African minerals producers, just as oil vulnerability is primarily linked to the question of Persian Gulf stability. Though it has become a cliché, there is some utility to the equating of southern Africa with the Persian Gulf, given that each region accounts for an impressive share of both world reserves and production. In 1980, the Persian Gulf produced about 30 per cent of the world's crude oil, and possessed 56 per cent of world reserves of conventional crude oil.[39]

By comparison, the southern Africa region (which comprises Angola, Botswana, Congo, Lesotho, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zaire, Zambia, and Zimbabwe) produced in 1980 the following percentage shares of total world production for the five commodities often cited as the most "strategic" of all non-fuel minerals: chromium 40.8; cobalt 68.7; manganese 21.3; platinum-group metals 45.4; and vanadium 33.4. Also in 1980, these African countries accounted for the following percentage shares of total world reserves: chromium 92.3; cobalt 22; manganese 44.7; platinum-group metals 82.2; and vanadium 48.9.[40] Dominating the production and reserves figures of the entire region is South Africa. It is the world's leading producer of platinum-group metals, gold, diamonds, vanadium, manganese, and chromium. As well, it is an important supplier of titanium, iron ore, nickel, copper, lead, silver, and zinc and is a small net exporter of tin and cobalt. It leads the world in the export of thermal coal, and is the second-largest exporter (after Canada) of uranium.[41]

Given its dominant position in several important mineral markets, it is not surprising that thinking about strategic minerals largely takes the form of thinking about the future of South Africa. Given that the "science" of political risk analysis has little predictive power, one cannot reasonably demand or expect precise statements about possible future interruptions in the supply of strategic minerals produced in that country. This does not mean that attempts should not be made to forecast probable developments affecting international minerals markets; it is simply to acknowledge the reality that all such attempts are empiricism. Econometric forecasting, which can give the superficial appearance of predictive prowess, can say nothing at all about the economic consequences of difficult-to-foresee political factors. The most that one can expect from political forecasting is that it proceeds on the basis of reasoned, or reasonable, conjecture.

In the matter of the "resource-war", we have seen that guesses as to the future mineral-supply prospects of the West are not, in fact, founded on reasoned premises. The same cannot be said of assessments of risks associated with southern Africa mineral supply. There is, in southern Africa, enough evidence of recent political turmoil to presage further instability. Moreover, there is the question of the domestic social order in South Africa; no one expects either a rapid or peaceful resolution of this issue. If South Africa possessed few or no minerals, then the implications of its social unrest would, for minerals analysts, be of little practical significance. But South Africa is not Northern Ireland, and until the West is able to reduce its dependence upon South Africa and its neighbours for various non-fuel minerals, the problem of reducing vulnerability to mineral-supply disruptions remains linked to political developments in the region.

Briefly, Western policy-makers believe consuming states have two principal concerns relevant to southern Africa. The first, and by far most prevalent, worry is that political turmoil will continue to grow in the region--with all that this entails for the continuation of mineral production. The second concern is that even if South Africa's mineral production were not diminished by domestic strife, its mineral exports might be curtailed, either because of a United Nations program of sanctions against South Africa or because the South Africans themselves have decided to exercise economic leverage against Western consumers who have taken diplomatic sides against them in the UN and elsewhere.[42]

The Reduction of Vulnerability and Its Implications for Canada

To South African proponents of the resource-war hypothesis, Western industrialized countries can best reduce their vulnerability to supply disruptions of strategic minerals if they assist South Africa in meeting the Soviet "threat", which in effect means supporting the domestic status quo there. Although this approach is supported by some in the West (especially in conservative American circles), it is far from being a preferred response of import-dependent Western countries. Perhaps there is no single policy that merits the description "preferred", but several options come to mind as more or less viable methods of mitigating vulnerability. The most important of these are stockpiling, import diversification, and increased domestic production, with substitution and conservation (including recycling) being of lesser significance.

As a major mineral exporter--and the world's leading exporter of non-fuel minerals--Canada has a clear interest in the vulnerability-reducing strategies that the Western consuming states adopt. More than 10 per cent of Canada's GNP is accounted for by mineral production (including fuels), which in 1980 totalled $32 billion, of which two-thirds was exported, reflecting the high propensity of Canada to export. In 1980 more than 20 per cent of Canadian merchandise-trade exports consisted of crude and fabricated non-fuel minerals. The United States takes most of Canada's mineral exports, including fuels--71 per cent in 1980. For the same year, Japan's share was 7 per cent, the EEC's (excluding Britain) was 6 per cent and Britain's was 4 per cent.[43]

Western countries, in attempting to alleviate their vulnerability in strategic minerals, adopt policies and take measures that could have an impact on Canadian export interests. Canada could be positively affected if nervous mineral importers saw it as a reliable supplier in an increasingly troubled world and began to look to Canada as the source of their supply. But Canada could be negatively affected by Western vulnerability-mitigating approaches: possibly the most menacing for Canadian interests would be attempts on the part of countries like the United States to attain greater self-sufficiency in minerals, either through more intensive development of domestic minerals, or some variant of "domestic" activity, such as seabed mining.

Canada would seem to rank as the most reliable mineral exporter. At least this is an assumption usually made prima facie by mineral analysts. The problems associated with mineral development in much of the world seem to be pleasantly absent in Canada: in particular, there is no impending political upheaval to curtail mineral production and exportation, and foreign investors, despite some grumblings, are still offered as hospitable an environment in which to carry on development as they are likely to find anywhere else. But while the assumption of Canadian reliability no doubt contains more reality than myth, it is still worth noting that not all mineral analysts consider Canada a haven for productive activity, nor would all recommend that their governments try to increase their dependence upon Canadian sources of supply. Some British commodities experts were dubious about Canada's reliability, either because of perceived labour unrest or an assumption that Canadian provincial governments, along with the federal government, continue to regard the mining industry with suspicion, if not hostility. One mineral analyst remarked that the only real minerals crisis in Britain in the post-war years occurred in 1969--and it concerned the disruption of Canadian nickel supply resulting from a seven-week strike.[44] To others, Canada is one of the countries where non-commercial or political risks associated with mining have grown because government intrusions into the mining sector have "intensified the difficulties of developing known deposits in some areas, be they British Columbia or Zaire."[45]

There have been other challenges to Canadian reliability as a mineral supplier. Sometimes the detractors focus on Canadian labour difficulties. For instance Japan attempted a greater diversification of its molybdenum supply when strikes at Canadian molybdenum mines in 1979 held up production.[46] Sometimes foreign policy goals, such as Ottawa's initiative to tighten safeguards on uranium exports in late 1976, have led to objections by consumers (in this case, Japan and the Euratom countries) who had previously considered Canada a very reliable supplier.[47] And, in extreme cases, there have been those who have objected to dependence upon Canadian mineral supply because they perceived Canada during the Trudeau years as an ideologically suspect country. According to this perspective, which seems to be confined to a very small minority in Washington, "the developing minerals and energy situation in Canada is such that the reliability of traditionally friendly Canada as a long-term source of strategic minerals for America must be questioned."[48]

Despite the undeniable existence of evidence that not all would regard Canada as a reliable source of supply, it remains a fact that most minerals analysts consider Canadian supply to be, if not perfect, nearly as safe as domestic supply, which itself can be and is subject to labour-related disruptions. Canada remains what it has always been in the decades following World War Two, a valued producer and supplier of various minerals. Whether Canadian export interests can expect to benefit from the recent wave of concern regarding mineral vulnerability depends primarily on whether Canada can increase its production of the minerals whose supply is held to be increasingly problematic. As we have seen, it is primarily those minerals whose production and reserves are concentrated in southern Africa that have occasioned the most concern in non-fuel minerals markets. These minerals may or may not be the most "strategic" minerals, but they do seem to be ones that are most often implicated in discussions of consumers' vulnerability: chromium, cobalt, manganese, platinum-group metals and vanadium.

Not all consumers have identical lists of problematic minerals. The United States, for example, regards vanadium as a strategic mineral, but there is no great worry about it, since the country is about 65 per cent self-sufficient in this mineral.[49] In addition to the "core group" of problematic commodities, other minerals are variously cited by consumers as being worthy of attention. In its study of the collective vulnerability of the alliance, the Economic Directorate of NATO mentions: asbestos (blue), titanium, columbium, tantalum, tin, tungsten and antimony, as well as the core minerals.[50] The European Community, in its own study of group vulnerability, lists the above (minus asbestos, tin, and tungsten) and adds phosphate rock, molybdenum and nickel.[51] France considers itself to have either a "very great" or "great" vulnerability in respect of silver, platinum-group metals, industrial diamonds, phosphate, zirconium, titanium, cobalt, vanadium, antimony, copper, manganese, molybdenum and tungsten.[52] Britain has recently begun a small-scale stockpiling program for strategic minerals, and though the details of the plan are allegedly confidential, the stockpile is believed to contain cobalt, chromium, manganese and vanadium.[53] West Germany had been planning to start a strategic stockpile in 1979 and 1980, but cancelled the program in November 1980. It was intended to hold stocks of chromium, manganese, cobalt, vanadium, and blue asbestos (or crocidolite).[54] Japan has at least two separate stockpiles, one to stabilize prices of certain non-ferrous metals (copper, lead, zinc, and aluminum) and another to provide a stable supply of what the Japanese call "rare metals" (nickel, chromium, molybdenum, cobalt and tungsten).[55]

As the above partial survey of problematic minerals reveals, once one departs from the "core group" of strategic minerals, there is little consensus on the importance of remaining materials. This lack of consensus, as noted above, is one of the best arguments for a broad construction of the term "strategic minerals". By virtue of its being the world's largest exporter of non-fuel minerals, Canada becomes, in the broad sense of the term, the world's principal supplier of strategic non-fuel minerals as well as an important exporter of natural gas, itself a strategic mineral. But Canada does not stand out as a supplier of the "core group" of problematic minerals at present. Indeed, Canada is 100 per cent dependent on imports for three of the five core-group minerals, a fact that has recently led some students of the Canadian minerals position to recommend that Ottawa contemplate creating a strategic stockpile program of its own.[56]

Canada is, however, an important producer of two of the five minerals in the core group: cobalt and the platinum-group metals. It is one of the half-dozen largest cobalt producers in the world and, though not in the same category as Zaire which accounts for half of global production, it furnishes a respectable 6 per cent of world cobalt supply. Canada ranks third in world production of platinum metals, and is responsible, again, for about 6 per cent of world mine output in this group. Both cobalt and platinum are by-products of copper and nickel production in Canada, as indeed they are in the USSR and in many other important producing countries.[57] What this means is that Canada cannot increase production of these two metals in response to supply disruptions in southern Africa unless the marketing prospects for nickel and copper (especially the former) are such as to permit economic expansion. If there was a total cut-off of the southern Africa supply of cobalt and platinum-group metals, the attendant price rises for the two metals might make exploitation of them so profitable that they could become the major products, with nickel and copper becoming co-products. But if such price rises were to come about, there would be a severe contraction in consumption, coupled with an increase in exploitation of currently marginal or sub-economic deposits in other countries. Thus, the net result would be either a global production share for Canada that is not appreciably different from the present share, or a larger relative share for Canada of a declining global output. In either event, it is difficult to see how Canada can expand its production of cobalt or platinum very much, unless nickel and copper production were to serve as the locomotive of such expansion.

Interestingly, there is probably some potential for Canada to enter production of two of the other core group minerals: chromium and manganese. Currently mining neither chromium nor manganese (though it did exploit some domestic chromium deposits in the Eastern Townships earlier in this century), Canada has both chromium and manganese deposits--resources that, according to some, might sustain economic production if prices were to rise "significantly".[58] Production prospects are probably greater for chromium than for manganese, and one of the most interesting recent developments with respect to strategic minerals in Canada is the work now being done by an Ottawa engineering firm to determine whether two Manitoba chromium deposits might warrant development. The deposits, in the Bird River and Euclid Lake areas, are the property of Dynamic Mining Exploration Ltd., which is not expected to make a decision whether to go into production for some years.[59] Canada's potentially exploitable chromium deposits are not limited to Manitoba; other provinces that have deposits are Quebec, Newfoundland, and Ontario. Canada has never produced manganese, but it does have some potentially exploitable deposits in Newfoundland, Nova Scotia, New Brunswick, and British Columbia.[60]

Whether Canada eventually produces its chromium or manganese or any other strategic mineral deposits depends ultimately upon whether such production is economic--or whether consumers would be prepared to absorb the costs associated with the production of uneconomic resources on political or security grounds. One must ask whether Canada is likely to benefit from whatever malaise Western consuming states might be experiencing with regard to their future supply of strategic minerals. It must be acknowledged that at the moment Western consumers are relatively more confident about future mineral supply than they were three or four years ago. If market forces alone are the relevant considerations in minerals acquisition, then it would seem that Canada has little chance of becoming a producer of minerals in which it does not already have some comparative advantage, such as nickel. But if political forces, which are difficult or impossible to predict, lead to disruption in consumers' mineral supply in future, then policies followed by those consumers might indeed have favourable implications for Canadian minerals interests.

Perhaps the clearest example of a consuming country intervening in the market in a manner that redounded (initially at least) to the benefit of Canadian export interests was the US application of two minerals policy measures during the Korean War years. The Defense Production Act of 1950 was employed by Washington to stimulate both domestic and foreign productive capacity of certain strategic minerals, the most important of which was nickel. Hundreds of millions of dollars in US government subsidies went to assist Canadian nickel companies--primarily Falconbridge and Sherritt Gordon--in expanding their capacity.[61] The Stockpiling Act of 1946 also was used in the Korean War to expand sales of Canadian minerals in the United States. Notwithstanding the existence of the Buy American Act, purchases for the US strategic stockpile during the 1950s were largely of foreign (often Canadian) materials; only four of the 64 stockpiled materials came from domestic sources and only an additional six had domestic content exceeding 50 per cent.[62]

Though seldom applied of late, the Defense Production Act continues to be amended and extended every few years; it could in future be employed as it was during the Korean War years, but at the moment there are no plans to employ US government funds in the expansion of Canadian productive capacity.[63] Similarly, the US strategic stockpile continues to exist, and is now administered under the authority of the Strategic and Critical Materials Stock Piling Act of 1979. Indeed, the stockpile is the core component of US minerals "policy", and it is by far the largest of the various stockpiles held by Western countries. Many of the stockpiled materials are items that Canada produces, but there are not likely to be significant Canadian sales to the stockpile in the next few years. Apart from small amounts of tantalum, some of which comes from Canada (the world's leading producer of tantalite ores), the United States had limited its stockpile minerals purchases in the past four years to bauxite from Jamaica and China, cobalt from Zaire, and platinum (iridium) from South Africa.[64] Nor are other Western consumers likely to be acquiring many Canadian minerals for their stockpiles, both because they are targeting their purchases on the core group of problematic minerals from southern Africa and because they have such small stockpiles (the British stockpile has a market value of only about US $70 million, compared with the US stockpile valued at more than $11 billion, with an ultimate goal of $17.5 billion).

From time to time there have been calls for an OECD stockpile of non-fuel minerals, modeled after the organization's International Energy Agency (IEA).[65] It is highly unlikely that such a collective stockpile will ever be established, nor is it likely that a collective stockpile on the smaller scale of the European Community will be created; the costs and administrative difficulties of such a stockpile seem too immense, and the risks associated with not stockpiling are not as great as those that impelled the United States to propose--and the rest of the OECD (except France) to join--the IEA a decade ago. On the level of the collectivity, both the OECD and NATO limit themselves to the monitoring of an individual country's stockpiling efforts. For its part, the EEC has a mineral "policy" that is not premised at all on stockpiles, but rather on the diversification of mineral supply. In reality, developmental imperatives of the EEC have led Brussels to channel its mineral-investment monies to the African, Caribbean, and Pacific (ACP) states, under the first and second Lomé Conventions. Of particular note is the EEC's SYSMIN scheme, designed to help offset reductions in an ACP country's capacity to produce or export certain minerals. In addition to SYSMIN, Lomé II established the fifth European Development Fund, which is to provide more than $5 billion, some of which is to be used to fund minerals exploration.[66] The use of EEC funds to subsidize production and exploration in the ACP states might be seen as a challenge to Canadian export interests, but in reality the degree to which Canadian producers might be harmed by EEC assistance to the ACP countries is held to be very slight in Ottawa.[67]

Many countries take the position that import diversification is a worthy foreign-policy aim, but none has developed policies that are specifically aimed at increasing purchases of Canadian minerals. This is not to say that Canada does not find customers for its mineral production. Rather, it simply points out that most of Canada's mineral exports are primarily a function of the normal workings of the international market and are not determined in any important way by non-economic calculations of states. (Coal sales to Japan may be an exception to this generalization.)

Conclusion

In sum, it is hard to see how recent Western concern for mineral security will translate into major direct gains for Canada as a mineral exporter. Canada will continue to fare well as a mineral supplier to the West when demand is strong; conversely, economic downturns will not be mitigated by any security-prompted purchases from Canada, primarily because of the nature of the core group of problematical minerals. Canadian production of cobalt and platinum-group metals cannot be appreciably increased unless nickel (and copper) production can be expanded, and Canada has no chromium, manganese, or vanadium production. Chromium production could conceivably get under way in Canada during the 1980s, but it would likely require some subsidization, either from Ottawa or from foreign governments. Among the latter, only Washington appears to be in a position to supply financial assistance for the purpose of creating a productive capacity in Canada. But whether the United States would once again employ Defense Production Act monies in Canada depends, among other things, on the possibility of its developing its own chromium resources in California, Oregon and Alaska.[68]

One of the few positive aspects of the recent slump in mineral markets has been the retarding--perhaps even the elimination--of the threat that deep seabed mining was felt to pose to Canadian land-based nickel and cobalt production in the late 1970s.[69] While it is still too early to say that manganese-nodule exploitation will never take place, it seems almost certain that Ontario and Manitoba nickel producers have been given at least a decade's reprieve. A few years ago, analysts were expecting deep seabed mining to commence in the late 1980s; today, few envision it occurring in this century--even assuming the dispute over the mining provisions of the Law of the Sea

Treaty is resolved.

Although Canada's ability to capitalize on Western vulnerability concerns might appear to be limited at present, one should not conclude that actual supply disruptions of southern Africa minerals would only affect those few commodities that have been the focus of attention in the past decade. Taking the single case of South Africa, we can reasonably state that whatever might disrupt the production and export of chromium, manganese, vanadium and the platinum-group metals would most likely also disrupt the production and export of titanium, iron ore, nickel, copper, lead and zinc, silver, tin, thermal coal and uranium. Canada is a major producer of all of these minerals, with the exception of tin. Thus it would be difficult to imagine how Canada's production and export of non-fuel minerals outside the core group of strategic minerals would not be affected by massive internal upheaval in South Africa or, indeed, by any sharp departure from current production and export patterns on the part of a future South African government, whether or not that government was an outcome of massive internal upheaval.

Notes

1. C.K. Leith, "Mineral Resources and Peace", Foreign Affairs 16 (April 1938): 515-6
2. Alfred E. Eckes, Jr., The United States and the Global Struggle for Minerals (Austin: University of Texas Press, 1979), Chapter 3, "Minerals and the Origins of World War II".
3. The decreasing relevance of mineral supply to a state's security was the thesis of the following writers in the early postwar period: Edward S. Mason, "American Security and Access to Raw Materials", World Politics 1 (January 1949):147-60; Harold J. Barnett, "The Changing Relation of Natural Resources to National Security", Economic Geography 34 (July 1958): 188-201; and Mancur Olson, Jr., "American Materials Policy and the 'Physiocratic Fallacy' 7 Orbis (No. 4 1963):670-88.
4. U.S. Executive Office, National Materials and Minerals Program Plan and Report to Congress (Washington: April 1982): 12.

5. Percy W. Bidwell, Raw Materials: A Study of American Policy (New York: Harper & Bros./Council on Foreign Relations, 1958): 32-3.
6. A.A. Archer, "Definition of Strategic Materials and the Means Currently Available to the United Kingdom Government to Identify Strategic Sources and Requirements", in Availability of Strategic Minerals, edited by Michael J. Jones (London: Institution of Mining and Metallurgy, 1980), 3.
7. Hans H. Landsburg, Minerals in the Eighties: Issues and Policies (Oak Ridge, Tenn.: Oak Ridge National Laboratory, Program Planning and Analysis, 1982), 20-1.
8. Sec. 12 of the Strategic and Critical Materials Stock Piling Revision Act of 1979, cited in U.S. General Accounting Office, Report to the Secretary of the Interior: Actions Needed to Promote a Stable Supply of Strategic and Critical Minerals and Materials (Washington: GAO, June 1982), 6.
9. V. Anthony Cammarota, "America's Dependence on Strategic Minerals", A Paper Presented to the Conference on Strategic Minerals and International Economic Assistance, Wilmington, Delaware, 9 December 1982. Of the 93 separate items held in the U.S. strategic stockpile, all but 13 are metals or minerals.
10. Phillip Crowson, Non-Fuel Minerals and Foreign Policy (London: Royal Institute of International Affairs, 1977), 3.
11. Amos A. Jordan and Robert A. Kilmarx, Strategic Mineral Dependence: The Stockpile Dilemma, The Washington Papers, Vol. 7, No. 70 (Washington: Center for Strategic and International Studies, Georgetown University, 1979), 18-19; Hans H. Landsberg and John E. Tilton, with Ruth B. Haas, "Nonfuel Minerals", in Current Issues in Natural Resource Policy, edited by Paul R. Portney, pp. 74-116 (Washington: Resources for the Future Inc., 1982), 91-5.
12. The national defence is contingent upon economic well-being in two senses. First, poorly functioning economies subject to political stresses that become too aggravated, can have profound implications for internal order. As Bruce Russett has observed,

"if continued stagnation or economic decline is politically intolerable, then every threat of denial of access to essential supplies of raw materials becomes a matter of central concern to the state." In a second context, we can say that military potential (that is, to cite Klaus Knorr, the "national resources available for producing and maintaining armed forces") varies, ceteris paribus, directly with changes in economic well-being. Note that military potential differs from military strength in being. Bruce M. Russett, "Security and the Resources Scramble: Will 1984 Be Like 1914?" International Affairs 58 (Winter 1981-82): 43; Klaus Knorr, Military Power and Potential (Lexington, Mass.: D.C. Heath, 1970), 15.

13. T. S. Lovering, Minerals in World Affairs (New York: Prentice-Hall, 1943), 237.
14. Donella H. Meadows, et al., The Limits to Growth (New York: Universe Books, 1972). For a critical analysis of the report's methodology and conclusions, see Harold J. Barnett, "Energy, Resources, and Growth" in U.S. Congress, Joint Economic Committee, Subcommittee on Priorities and Economy in Government, Resource Scarcity, Economic Growth, and the Environment, 93rd Congress, First Session (Washington: U.S. Government Printing Office, 1974), 171-90.
15. Richard N. Cooper, "Natural Resources and National Security", Resources Policy 1 (No. 4 1975): 192-3.
16. John E. Tilton, The Future of Nonfuel Minerals (Washington: Brookings Institution, 1977), 92.
17. U.S. General Accounting Office, Report to the Secretary of the Interior: Federal Encouragement of Mining Investment in Developing Countries for Strategic and Critical Minerals Has Been Only Marginally Effective (Washington: GAO, September 1982), 3.
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19. Energy, Mines and Resources Canada, Mineral Policy: A Discussion Paper, December 1981 (Ottawa: Minister of Supply

and Services, 1981), 146.

20. Phillip Crowson, "Trend and Patterns of International Investment in Non-Fuel Minerals" in Probleme der Rohstoffsicherung (Bonn: Friedrich Ebert Stiftung, 1981), 25-6.
21. T.P. Mohide, C.L. Warden, and J.D. Mason, Towards a Nickel Policy for the Province of Ontario, Mineral Policy Background Paper No. 4, December 1977 (Toronto: Ontario Ministry of Natural Resources, Division of Mines, 1977), 12-3.
22. P.C.F. Crowson, "Investment and Future Mineral Production", Resources Policy 8 (No. 1 1982): 7-9.
23. Contrasting viewpoints are advanced in Marian Radetzki's self-described "optimistic" paper, Will the Long-Run Global Supply of Industrial Minerals Be Adequate? A Case Study of Iron, Aluminium and Copper, Reprint Series No. 132 (Stockholm: University of Stockholm, Institute for International Economic Studies, 1980); and the more pessimistic article by N. A. Butt and Thomas Atkinson, "Shortfalls in Minerals Investments", Resources Policy 8 (No. 4 1982): 261-76.
24. Two works deserve to be considered loci classici of this kind of analysis: The Resource War in 3-D--Dependency, Diplomacy, Defense, edited by James Arnold Miller, Daniel I. Fine, and R. Daniel McMichael (Pittsburgh: World Affairs Council of Pittsburgh, 1980); and National Strategy Information Center, The Resource War and the U.S. Business Community: The Case for A Council on Economics and National Security (Washington: Council on Economics and National Security, 1980).
25. National Strategy Information Center, Strategic Minerals: A Resource Crisis (Washington: Council on Economics and National Security, 1981), 24.
26. Steven J. Warnecke, "International Security Implications of Soviet Energy and Raw Materials Policies" in Probleme der Rohstoffsicherung, 127.
27. W.C.J. van Rensburg, "Political Change in South Africa and the Importance of the Republic of South Africa as a Raw Material Supplier" in Probleme der Rohstoffsicherung, 99.

28. I base this remark on conversations with minerals analysts in various Western European capitals, and at NATO, EEC, and OECD headquarters in March and April 1983.

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30. Warren P. Baker, "Next: A Resource War?" Seapower 23 (October 1980): 55.

31. Walter J. Levy, "Oil and the Decline of the West", Foreign Affairs 58 (No. 5 1980): 1015.

32. John Orme, "Ore Wars: The Problem of U.S. Dependence on Foreign Minerals", Fletcher Forum 6 (Summer 1982): 408. By October 1982, the spot market price for cobalt had dropped to a low of $4.25/lb. Energy, Mines and Resources, Canada, The Canadian Mineral Industry: Monthly Report (Ottawa: February 1983), 12. (Hereafter cited EMR Monthly Report.)

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34. Landsberg, Minerals in the Eighties, 19-20.

35. U.S. Congress, House Committee on Foreign Affairs, Subcommittee on Africa, The Possibility of a Resource War in Southern Africa, 97th Congress, First Session (Washington: U.S. Government Printing Office, 1981), 67.

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38. See, for this view, Daniel I. Fine, "Mineral Resource Dependency Crisis: Soviet Union and United States", in The Resource War in 3-D, 37-56.

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41. Dirk C. Neethling, "The Geopolitics of Mineral Supply: Access to and Availability of the Mineral Resources of Southern Africa", A Paper Presented to the Conference on Southern Africa Metals and Minerals in a World Context, Johannesbrug, May 1981.

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44. Interview, London, 12 April 1983.

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47. Ted Greenwood and Alvin Streeter, Jr., "Uranium" in Natural Resources in U.S.-Canadian Relations. Volume 2: Patterns and Trends in Resource Supplies and Policies, edited by Carl E. Beigie and Alfred O. Hero, Jr. (Boulder: Westview Press, 1980), 356-7.

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49. U.S. Bureau of Mines, Mineral Commodity Summaries: 1983 (Washington: Department of the Interior, 1983), 168.

50. Interview, NATO Headquarters, Brussels, 29 March 1983.

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54. Interviews, Frankfurt and Bonn, 24/25 March 1983.
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57. Canadian Minerals Yearbook: 1980, 133-9, 349-57.
58. EMR, Mineral Policy, 34.
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61. John E. Cameron, "Nickel", in Beigie and Hero, Natural Resources in U.S.-Canadian Relations. Volume 2, 69.
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64. U.S. Federal Emergency Management Agency, Stockpile Report to the Congress, October 1981-March 1982 (Washington: September 1982), 15.

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66. House of Lords, Strategic Minerals, viii-ix.

67. EMR, Mineral Policy, 151.

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69. See, for instance, W.E. Cundiff, Nodule Shock? Seabed Mining and the Future of the Canadian Nickel Industry, Occasional Paper No. 1 (Montreal: Institute for Research on Public Policy, 1978).

8: EXCHANGE-RATE BEHAVIOUR AND THE FUTURE OF THE MANAGED FLOAT

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EXCHANGE-RATE BEHAVIOUR AND THE FUTURE OF THE MANAGED FLOAT

Introduction

The period from the end of World War Two to the early 1970s was one of almost fixed exchange rates, a regime known as the adjustable peg or Bretton Woods system. During the fixed-rate period there was a prolonged debate on the relative merits of fixed and floating exchange rates. Those opposed to floating exchange rates[1] argued that exchange risk and uncertainty in a floating regime would impede international trade, that floating would cause frequent and costly re-allocations of factors between sectors, that it would remove a source of restraint on domestic monetary authorities, and that it would be subject to destabilizing speculation. Those in favour of floating exchange rates[2] countered that exchange risk could be hedged, that exchange rates would be stable as long as the underlying economy was stable, that floating rates would be a source of discipline by providing early warning signals of unfavourable economic trends, and that profitable speculation is a stabilizing force. Proponents of the floating rate also pointed to the destabilizing effects of one-way speculation under fixed rates.

In addition, floating rates had the theoretical appeal of insulating the domestic economy from foreign economic shocks. Under a system of fixed exchange rates, a balance-of-payments deficit or surplus directly affects the domestic money supply and hence domestic economic activity. Under a system of free floating rates, the exchange rate adjusts so that the balance of payments is always zero. Therefore external adjustment does not directly alter the domestic money supply.

Apart from the period between the two World Wars and Canada's experience with a floating rate from 1950 to 1962, there was little evidence available to resolve the fixed-versus-floating debate. Then, in the late 1960s, exchange-rate parities were adjusted frequently, putting stress on the Bretton Woods arrangements. The system broke down completely in the early 1970s as all the major industrialized countries floated their currencies. Although this was intended to be a temporary measure, floating has continued to the present.

Generalized floating brought two major surprises. First, floating exchange rates did not provide complete insulation of the domestic economy from external influences. The floating period has been characterized by rapid international transmission of inflationary price shocks and a large degree of synchronization of business cycles among industrialized countries.

The second surprise in the floating regime was that exchange rates fluctuated far more than most analysts expected. At first the fluctuations were blamed on the extraordinary political and economic circumstances of the early and mid 1970s (Mideast war, oil and commodity price shocks, world recession). However, exchange rates continued to fluctuate, at times in quite an extreme manner, and this has been a continuing source of concern to national authorities. As a result, many countries have decided not to let their exchange rates be determined entirely by private supply and demand, and central banks have intervened frequently in the foreign-exchange markets. The exchange-rate system has thus come to be known as a "managed" or "dirty" float.

Different central banks have intervened to varying degrees. Currently the Bank of Canada is an active intervener. In contrast, the United States has intervened only a handful of times under the Reagan administration. A number of European countries have pegged their currencies together in an arrangement known as the European

Monetary System.[3]

Continued exchange-rate volatility and problems with international inflation have led to a revival of the debate on fixed-versus-floating exchange rates. There is interest in a return to fixed--or less flexible--exchange rates. Some time ago, President Mitterand of France called for a new Bretton Woods conference.[4] Central bankers also have been discussing co-ordination of intervention in response to disorderly currency markets.[5]

After approximately ten years of floating exchange rates, there is now enough data available to begin to evaluate the floating-rate experience. This paper will briefly review some of the literature on exchange-rate behaviour in the 1970s and will then focus more particularly on tests of foreign-exchange market efficiency. This will be followed by a more general discussion of whether exchange-rate volatility has been excessive and some thoughts on the future of the managed float.

The Literature on Exchange-Rate Behaviour

There are various ways to go about answering the question of whether exchange-rate volatility has been excessive. Two approaches will be distinguished here. The first asks whether exchange-rate fluctuations are in line with the behaviour predicted by economic models of exchange-rate determination. The second examines the efficiency of foreign-exchange markets. This paper will focus on the second approach after outlining some general results from the first.

The most popular exchange-rate models in the last decade have been monetary and portfolio-balance models. They range from simple purchasing power parity calculations to complex models incorporating rational expectations and dynamic adjustment. Frankel provided a useful diagrammatic summary of the families of models.[6] The very proliferation of models suggests that they have not been entirely successful in explaining exchange-rate behaviour.

For example, while there is evidence that exchange rates reflect relative price movements in the long-term, purchasing power parity models do not do a good job of explaining exchange rates in the short-

and medium-term. As another example, there seems to be a lot of instability in the empirical estimates of the monetary and portfolio-balance models. This has led some researchers to suggest that exchange rates include a time-varying risk premium. On the other hand the underlying assumptions, such as the assumption of a stable money demand function, may be at fault. Similarly, empirical studies of rational expectations models have produced mixed results. Since they jointly test the hypothesis of rational expectations and a particular model specification, their failure could be due either to violation of the rational expectations hypothesis or to model misspecification.

Several empirical studies compared the explanatory power of various monetary and portfolio-balance models. No one model seemed to stand out as better than the others, and some researchers found that not one of the models was satisfactory. Lafrance and Racette found that a portfolio-balance model was superior to four monetary models in explaining the Canadian dollar-US dollar quarterly exchange rate from 1971:I to 1980:IV.[7] Driskill studied two models of exchange-rate dynamics using quarterly data for the Swiss franc-US dollar exchange rate from 1973 to 1977.[8] His results tended to support the stock/flow (i.e. portfolio) version of the model. In contrast, Frankel suggested that the monetary approach may be preferred to the portfolio-balance approach in explaining the monthly US dollar-German mark exchange rate for January 1974 to October 1978.[9]

Meese and Rogoff compared the forecasting abilities of a number of popular monetary models and a few time-series models for the US dollar.[10] Their results were not encouraging. They found that a random-walk model had the best predicting record for forecasting up to a year ahead. Comparisons of commercial exchange-rate forecasting services have found that no one service or type of forecasting technique (e.g. econometric, judgmental) consistently dominated and that at times the forward exchange rate has been a better predictor of future spot rates than the services.[11]

Hacche and Townend compared the explanatory power of a large number of models applied to the effective exchange rate of the British pound using monthly data from 1972 to 1980. They concluded their study as follows:

> The predominant impression left by our results is one of failure: we have not succeeded in finding empirical regularities in the data to help explain in any satisfactory way the fundamental determinants of sterling's effective exchange rate during the floating-rate period. Our research has failed, often dramatically, to yield empirical support for any of the theories we tested (including most notably, the monetary model); and we are left without any stable empirical relationship which might be used for forecasting the exchange rate.[12]

The overall impression from these empirical studies is that the relationship between exchange rates and underlying economic variables may be unstable and that the models do not provide close fits or accurate forecasts for exchange rates. Since most of the models are monthly or quarterly, they do not capture the acute short-term exchange-rate volatility that has characterized the floating-rate period and thus can only partially answer the question of whether exchange-rate volatility has been excessive.

The efficiency approach to analyzing exchange-rate behaviour does not depend on the specification of a model of exchange-rate movements. The efficient markets hypothesis states that prices in a given market fully reflect all the information available to traders in that market. The market price of a currency--a spot, forward or futures exchange rate--can be viewed as a forecast of the future exchange rate. If the foreign-exchange market is efficient, the price of a currency reflects everything that foreign-exchange traders know about the current value and prospects for that currency at that point in time. A number of testable hypotheses are implied by market efficiency:

- Market exchange rates are unbiased forecasts of future exchange rates. This implication is usually examined by testing whether the mean forecast error is significantly different than zero or by regressing the actual future exchange rate on the forecast and testing whether the intercept is zero and the slope is one. These will be referred to as tests for unbiasedness.

- Today's exchange rate is the best forecast of the exchange rate at any time in the future. This means that the exchange rate follows a random walk or martingale process.[13] If the current exchange rate is the best forecast, it means that all available information has been exploited in making that forecast and any forecast error is uncorrelated with the information on which the forecast is based. This implication can be tested by looking at the correlation between the forecasts or forecast errors and previous (lagged) forecasts, forecast errors, or other information known when the forecast is made. The tests can be done with regression analysis, time series analysis, spectral analysis, or non-parametric procedures like runs analysis. These will be referred to as correlation tests of efficiency.
- There are no consistently unexploited profit opportunities; i.e., on average it is not possible to beat the market. This implication is tested by comparing the profits generated by using different forecasts or trading rules. These comparisons will be called tests for unexploited profits.
- Exchange-rate variation is no greater than the variation of the underlying determinants of the exchange rate. A relatively new set of tests known as variance bounds tests has been developed to investigate this implication.

The literature on market efficiency originated in the study of stock and commodity markets. Its application to foreign-exchange markets is relatively recent. Empirical studies of foreign-exchange market efficiency through 1978 were surveyed by Kohlhagen and Levich.[14] Table 1 presents an updated bibliography with the listings grouped according to the four categories of efficiency tests given above.

Most of the empirical work on foreign-exchange market efficiency used data from the recent floating-rate period, although a few studies examined exchange rates in the 1920s, and some samples were drawn from the Bretton Woods period. The dominant impression from surveying these studies is one of mixed and conflicting results. The conclusions about foreign-exchange market efficiency vary with the statistical tests used and the currencies and sample periods studied.

A number of authors have applied different tests to the same data set and produced contradictory results. For example, Loque and Sweeney found evidence of efficiency in the French franc-US dollar market between January 1970 and March 1974 using spectral analysis, but they found unexploited profits when comparing trading rules to buy-and-hold strategies.[15]

The same test applied with slightly different statistical procedures can produce different results. Krasker[16] illustrated this point by using different distributional assumptions to reverse the inefficiency conclusions of Frenkel[17] in unbiasedness tests on the German mark-British pound forward market in 1921-23. Garber also reversed Frenkel's results, but his approach involved sampling forecasts more frequently and accounting for autocorrelation in estimation.[18]

Cargill and Rausser pointed out that tests of the random-walk hypothesis in commodity markets tend to reject efficiency more often when the sample size is large.[19] Summers argued that financial markets may be less efficient than the empirical literature suggests because correlation and unexploited profits tests have low power against certain types of inefficiency.[20]

There is some evidence that the efficiency conclusions are not stable across different sample periods. There seems to be more inefficiency when exchange rates are volatile. For example, Frankel tested forward-rate bias in the January 1973-April 1978 period and rejected the efficiency hypothesis for the German mark, French franc, Italian lira, and Dutch guilder markets.[21] He repeated the test omitting the volatile period before July 1974 and rejected efficiency only for the Italian lira. Frenkel and Levich divided their 1962-75 sample period into three sub-periods, which they named "the tranquil peg" (1962-67), "the turbulent peg" (1968-69), and "the managed float" (mid 1973-75).[22] They compared the three sub-periods on the basis of the transactions costs and profit opportunities of covered-interest arbitrage and also on the basis of spot and forward efficiency (correlation tests). The sub-periods differed substantially. There was the greatest evidence of unexploited profits in the turbulent peg period, but this was also the period giving greatest support to the random-walk hypothesis. Other studies that identified periods of differing exchange-rate volatility, transactions costs, or efficiency include those by: Aliber, Geweke and Feige, Gupta, Logue et al., Overturf, and Stockman.[23]

Clearly, the estimation and statistical testing techniques chosen can make a significant difference in the efficiency conclusions. Additional research is required on the appropriate testing techniques for efficiency. The variations in results from different periods suggest that foreign-exchange markets tend to be efficient under normal trading conditions but inefficient in times of volatile exchange rates, perhaps due to speculative activity. Additional evidence on testing techniques and the connection between inefficiency and volatility will be presented in the next section.

Some Evidence on the Efficiency of Foreign-Exchange Futures Market

So far the discussion has concentrated on spot and forward markets for foreign exchange. In this section, the focus shifts to futures markets, beginning with a brief description of the difference between interbank and futures markets.

Spot and forward exchange rates are determined in the interbank market. The interbank market is known as a wholesale market because the traders are large institutions (commercial banks, brokers, multinational corporations, central banks) and because the size and depth of the market result in the best prices being quoted there. Futures markets in foreign exchange have been established by commodity exchanges and are a relatively new phenomenon. Futures traders include individuals, brokerage firms, and, increasingly, large financial institutions and corporations. The Chicago Mercantile Exchange was the first to establish foreign-exchange futures trading, opening a division called the International Monetary Market (IMM) in May 1972. The New York Futures Exchange and other small exchanges have followed, but the IMM remains the dominant currency futures market in volume and influence.

A currency futures market operates like a commodity futures market. There are fixed contract sizes and delivery dates. Traders must be exchange members, and they deal face-to-face in a trading pit. In contrast, interbank spot- and forward-exchange contracts are made by telephone or telex. Interbank contract sizes and delivery dates are tailored to the needs of the transactors, and the transactions are generally much larger than futures trades. Interbank exchange rates are quoted for exchanges of some multiple of a million dollars, whereas the futures price applies to a standard contract worth about a hundred thousand dollars. Forward and futures exchange rates are alike in that both are forecasts of on-the-spot exchange rates on the delivery date.[24]

This section reports the results of some efficiency tests applied to the IMM currency futures markets. Four actively-traded currencies were chosen for study: the British pound, the Canadian dollar, the German mark, and the Swiss franc. All contract prices are quoted versus the US dollar. The sample covers 30 contracts with delivery dates from September 1972 to December 1979. Trading for the first contracts began in May 1972. The trading periods for the 30 contracts are described in Table 2.

The data are in the form of 30 daily time series of settlement (closing) prices. Each daily futures price is a forecast of the exchange rate on the delivery date. Thus the forecast horizon is fixed. The forecasts will first be tested for unbiasedness and then for lack of correlation of successive price changes.

Two problems of efficiency testing are avoided by using data with a fixed forecast horizon. First, the econometric difficulties of overlapping forecast intervals do not arise.[25] Second, the efficiency test is not a joint test of efficiency and a model of the equilibrium exchange rate, a problem highlighted by Levich.[26] This is because the exchange rate being forecast is at a fixed point in time. It is not a moving target.

The first part of the analysis is a test for forecast bias using mean percentage forecast errors. The percentage forecast error is the difference between the spot exchange rate on the last day of trading and the futures price a given number of (business) days before the end of trading, calculated as a percentage of the spot rate. Cross-sections of such forecast errors were taken from each of the thirty contracts at varying numbers of days to delivery (e.g. forecast errors at five days to the end of trading for the September 1972 contract, the December 1972 contract, etc.). The mean and standard deviation of this group of same-horizon forecast errors was then computed. The hypothesis that the mean percentage forecast error was zero was tested with a t-statistic. These calculations were repeated for each currency and for forecast horizons of one to 119 days. In some cases there were fewer than 30 observations in the cross-section due to the occurrence of holidays.

There were 504 t-tests (119 for each of the four currencies). Table 3 presents a sample of the results. It reports the mean percentage forecast errors and t-statistics for one to twenty days before the last day of trading. The results strongly support the unbiasedness hypothesis. Only two of the mean forecast errors in Table 3 are significantly different from zero (at the 5 per cent level). These are the German mark and Swiss franc forecast errors at one day to delivery. Futures trading volume is extremely low at the end of a contract's life, so large forecast errors are not surprising close to the delivery date. In the 119 t-tests, the British pound had no significant t-statistics, the Canadian dollar had four, the German mark two, and the Swiss franc two. The overall conclusion is that the futures price was on average an unbiased predictor of the subsequent spot price over the 1972-79 period.

The tests were repeated using the futures price on the last day of trading instead of the spot price. This made them comparable to the tests done by Panton and Joy,[27] who found no bias in the forecast errors for the same currencies between 1972 and 1976. The results in this second set of tests were virtually identical to those reported above.

Forecast accuracy should improve as the delivery date approaches as more information becomes available. The variance of the forecast errors should therefore decrease as the number of days to delivery decreases. In fact, if futures prices follow a random-walk process, the variance should decrease linearly with time to delivery. As expected, the variances of the cross-sections of forecast errors do decrease, although not always in a linear fashion.[28]

The next set of tests are correlation tests of efficiency in the four markets individually and as a group. These tests used the time series of daily futures prices and were repeated for each of the 30 contracts. The tests took the form of regressions of each day's futures price change (the difference between that day's price and the previous day's price) on information available to traders on that day. The information set was represented by the price changes from the ten previous trading days (two business weeks) in each of the four markets. Thus there were four regression equations, each with 40 right-hand side variables. Market efficiency implies that the 40 slope coefficients and the intercept term in each equation should all be zero. This lack of correlation between price changes in one market and information from the group of markets will be referred to as multimarket efficiency.

The regression equations for the four markets are likely to be related to each other for two reasons. First, since all the exchange rates are quoted in terms of the US dollar, any news regarding the US currency is likely to affect all four exchange rates, although not necessarily in the same direction (e.g., the Canadian and European might move in opposite ways). Second, activity in one currency market, especially heavy trading, frequently spills over into other markets. Therefore the set of regressions was estimated jointly to test the hypothesis that all four markets simultaneously have price changes that are uncorrelated with the common information set.[29]

This hypothesis will be referred to as joint multimarket efficiency. The choice of a multimarket information set and a joint estimation procedure follows the conclusions of Geweke and Feige.[30] Hansen and Hodrick and Hakkio also used multimarket information sets in their tests.[31]

The test statistic for the multimarket tests is an F-statistic with 41 and n degrees of freedom, where n is the regression degrees of freedom. The joint multimarket test statistic is distributed as chi-squared with 164 degrees of freedom. The F- and chi-squared statistics are presented in Table 4. Details of the estimation procedures and test statistics are reported in Glassman.[32]

There was strong rejection of multimarket and joint multimarket efficiency in the first six contracts (which included trading from May 1972 to December 1973). This was the turbulent period of transition from fixed to floating exchange rates, which suggests a connection between inefficiency and market turbulence. This was also the beginning of currency futures trading, so the inefficiency could have resulted from a learning period at the International Monetary Market. However, the reappearance of inefficiency later in the sample indicates that a learning process alone cannot account for the observed inefficiency.

Strong evidence of joint multimarket inefficiency appeared again in contracts that traded in the June 1974-September 1975 period and in January 1977-June 1979. The latter period corresponds to a time of heavy selling pressure on the US dollar in response to US current-account deficits. The former period was one of severe world-wide recession, when the US dollar generally fell in value against other major currencies.

Multimarket inefficiency appeared less frequently, but there were concentrations of significant test statistics at the beginning and at the end of the sample period. The more frequent rejection of inefficiency in joint tests compared to the tests on individual markets illustrates once again that the efficiency conclusions can change with the estimating and testing techniques used. The joint estimation procedure and tests were based on the assumption of a large sample size. With time series ranging from 76 to 303 observations this assumption seemed justified. However, the statistical test results proved sensitive to the sample size. In some cases, adjusting the test statistics for the exact sample size changed the efficiency conclusions.[33]

The inefficiency, when it existed, apparently did not persist over many days. Hypothesis tests on groups of coefficients indicated that there was more correlation between price changes and the preceding week's price changes than there was between price changes and two-week-old information. This suggested that many episodes of serially-correlated price changes tend to persist for only a few days.

In this study, as in several cited above, there was a conflict between the results from different efficiency tests. The tests for unbiasedness supported the hypothesis of efficiency for the period as a whole, while the correlation tests indicated that there may have been inefficiency in parts of the sample period. The results are not completely comparable since the correlation tests were applied to time series while the unbiasedness tests were applied to cross-sections of the 30 contracts (some of which showed correlation test inefficiency and some of which did not).

The results from the two sets of tests are not necessarily contradictory. A forecast can be unbiased at the same time that the series of forecast revisions is correlated; for example, forecasts could cycle around an unbiased mean. All that is needed for unbiasedness is for the positive forecast errors and negative forecast errors to balance out. Forecast bias and correlation are thus two different kinds of inefficient exchange-rate behaviour.

It has been recognized elsewhere in the literature that it is possible for a market to fail an efficiency test and still be efficient in the broad sense of reflecting all available information. For example, the existence of a risk premium could cause biased forecasts in spite of efficient information processing. Summers discussed other examples of rational behaviour leading to rejection of efficiency[34], including Blanchard and Watson's "rational bubbles".[35]

Foreign-Exchange Efficiency and Market Volatility

What conclusions regarding foreign-exchange market efficiency can be drawn from the studies described above? First, the evidence on foreign-exchange market efficiency is not conclusive. The sensitivity of the results to different kinds of tests, different estimating procedures, and different choices of tests statistics is disturbing. Future research should compare more thoroughly the results from different tests applied to the same data.

The second conclusion from efficiency research is that inefficiency may be more likely in time periods when foreign-exchange markets are described as volatile. The evidence is still only suggestive. More precise identification of both volatile periods and periods of foreign-exchange market inefficiency is needed. Since inefficiency implies that exchange rates are responding to influences other than economic fundamentals, the establishment of a link between inefficiency and market volatility would help to explain the apparent instability of structural models of exchange-rate determination over time.

A third, tentative conclusion from the efficiency literature is that inefficiency may be a short-term phenomenon. The evidence from futures markets suggests that correlation of price changes lasts a few days. If this is the case, inefficiency would not be a major problem in forecasting or policy-making or economic modeling based on monthly or quarterly trends. However, short-term inefficiency would make the exchange rate at any point in time an unreliable forecast.

The source of short-term exchange-rate movements is likely to be varying market expectations. Many speculative foreign-exchange traders have very short trading horizons. They do not buy and hold currencies for long periods of time but instead seek the potentially larger and less risky profits from trading the short-term ups and downs. They pay little attention to long-term trends of economic fundamentals (whose values are announced only on a monthly or quarterly basis) and much attention to a few frequently changing variables (e.g., interest rates and money supply figures) and to market mood.

Keynes, in describing the role of expectations in the stock market, explained that the successful trader is the one who guesses where the market is going ("under the influence of mass psychology"), not where it should be going, on the basis of true economic valuation.[36] A short-term forecasting horizon is thus perfectly rational because it is profitable. Keynes recognized that speculation on long-term trends could be profitable as well, but he pointed out that it is very risky. As noted in the empirical results above, the variance of the forecast errors increases as the forecast horizon increases.

Has there been excessive exchange-rate volatility under managed floating? This remains an open question. The evidence of foreign-exchange market inefficiency suggests that exchange rates may be subject to expectation-induced runs. This evidence supports the findings that exchange-rate models often do not fit or forecast very well in the short- and medium-term. It is certainly true that there has been enough volatility to focus almost continual attention on exchange rates. The extent of central bank intervention and frequently-voiced concerns about the degree of volatility indicate that public officials at least are not happy with the fluctuations. Corporate treasurers have been kept busy devising strategies to hedge exchange risk and reduce foreign exchange exposure. This has become a big business--and a costly one. The resources expended in these activities would be freed for other purposes if exchange rates were more stable.

Implications for the Managed Float

What measures can be taken to reduce exchange-rate volatility? The spectrum of possibilities includes returning to a world-wide system of fixed exchange rates (or even a gold standard), following policies aimed at stabilizing underlying economic variables (such as money supply growth), pegging groups of exchange rates together (like the European Monetary System), and increasing central bank intervention to smooth exchange-rate movements. Each of these possibilities will be discussed briefly.

The present condition of the international monetary system does not favour a return to pegged exchange rates or to a gold standard in the near future. Countries have become accustomed to the policy autonomy offered by flexible exchange rates (even if it falls short of complete insulation from external shocks and complete monetary policy independence). The frequent realignments of the European Monetary System suggests that a new system of fixed exchange rates would be subject to the same strains that broke apart the Bretton Woods system, namely, divergent economic policies and performances. The unsettling economic events of recent years, including oil price shocks, inflation, recession, and high interest rates, are not conducive to tying currencies together at this time. If economic recovery is followed by a few years of stable growth, a consensus may develop for a return to a fixed-rate regime.

Friedman argued that an unstable exchange rate is not a problem itself but rather a symptom of inappropriate economic policies.[37] Hence the cure for exchange-rate volatility is a stable underlying economy. While this solution is theoretically appealing, it is not likely to be implemented. For years the leaders of industrialized countries have met at economic summits and pledged to harmonize and stabilize their economies. Then they have gone home and pursued their own unharmonious, destabilizing domestic policies. Domestic politics simply overwhelm international promises.

There is already a fair degree of exchange-rate pegging in the international monetary system in the form of formal exchange arrangements like the European Monetary System and the active intervention policies of a number of central banks. In addition, the vast majority of the non-industrial countries peg their currencies. Individual or joint intervention could be extended by international agreement. However, the Reagan administration's reluctance to intervene frequently in foreign-exchange markets makes an international agreement on co-ordinated intervention or exchange-rate targets unlikely during its term of office. Thus if Canada, for example, wants a stable US dollar-Canadian dollar exchange rate, it must bear the burden of intervention. When a big player like the

United States is opposed, co-ordinated intervention possibilities are severely limited.

The most likely near-term development is increased commitment to exchange-market intervention by individual central banks rather than co-ordinated intervention. However, the effort to stabilize exchange rates via intervention will probably prove unsatisfactory. Large-scale swings will continue as long as economies diverge. Day-to-day fluctuations will continue as long as expectations fluctuate and profit opportunities exist.

Another reason that intervention will be unsatisfactory is that it is hard to implement. Successful intervention requires the central bank to interpret market trends as skilfully and as profitably as speculators do and to be able to act without the market guessing its strategy. Like successful speculation, successful intervention is profitable. Central bankers have not shown themselves to be particularly successful foreign-exchange traders. Taylor found that central banks generally lost money on their intervention activities in the 1970s.[38]

Many central banks currently intervene by "leaning against the wind". This strategy involves slowing any exchange-rate movements, although in practice it has often meant pegging the exchange rate at the existing level until it becomes obvious that the equilibrium level has changed.[39] This type of intervention presents opportunities for one-way speculation. More two-way intervention is required to make central bank foreign-exchange dealings less predictable and therefore more successful in affecting exchange rates.

Any change that occurs is unlikely to be a consciously planned, institutionalized one like the establishment of the Bretton Woods system. It is more likely to evolve in a piecemeal fashion, like the managed float did in the early 1970s. Over the next few years, dissatisfaction with intervention as a tool to counteract exchange-rate fluctuations will prompt a search for new intervention tactics and continued discussion of a formal return to a system of less flexible exchange rates. After ten years of floating exchange rates, it is now evident that volatility is a permanent feature of the floating-rate system. If national authorities conclude that the costs of exchange-rate volatility are too great to bear, the only feasible alternative is to move towards more fixed exchange rates. However, they are unlikely to agree to the policy sacrifices required until the world economy enters a period of sustained economic growth.

Notes

1. R. Nurske, "Conditions of International Monetary Equilibrium".
2. M. Friedman, *Essays in Positive Economics*.
3. The European Market System includes all European Common Market countries except Britain. It evolved from the European Narrow Margins Agreement of 1972, popularly known as the snake. The snake involved pegging participating currencies to each other and floating jointly against the US dollar and other currencies. The EMS was started in 1979 and specified parities relative to a European basket currency. Both appreciating and depreciating currency countries are required to intervene to maintain the parities, and a pool of funds is available for intervention.
4. See, for example, Art Pine, "Bretton Woods II? Global Monetary Ills Stir Talk of Revising Floating Rate System" for a discussion of the pros and cons of such a conference.
5. The term "disorderly" has never been precisely defined, although it is used frequently by monetary authorities. It is generally applied to foreign-exchange markets when exchange-rate changes are large and erratic. Its connotation is that the exchange rates are not moving in line with underlying economic fundamentals.
6. J.A. Frankel, "Monetary and Portfolio-Balance Models of Exchange-Rate Determination".
7. R. Lafrance and D. Racette, "The Canadian-US Dollar Exchange Rate: A Test of Alternative Models for the Seventies".
8. R.A. Driskill, "Exchange-Rate Dynamics: An Empirical Investigation".
9. Frankel, "Monetary and Portfolio-Balance Models".

10. R. Meese and K. Rogoff, "Empirical Exchange Rate Models of the Seventies: Are Any Fit to Survive"?

11. See for example R.M. Levich, "Analyzing the Accuracy of Foreign Exchange Advisory Services: Theory and Evidence".

12. G. Hacche and J. Townend, "Exchange Rates and Monetary Policy: Modelling Sterling's Effective Exchange Rate, 1972-80", p. 243.

13. Strictly speaking, the martingale process is the appropriate model for efficiency, for the random walk model imposes additional restrictions on the distribution of exchange rates (see Paul Samuelson, "Proof That Properly Anticipated Prices Fluctuate Randomly", and Benoit Mandelbrot, "Forecasts of Future Prices, Unbiased Markets, and 'Martingale' Models" and "When Can Price be Arbitraged Efficiently? A Limit to the Validity of the Random Walk and Martingdate Models". However, the terms are often used interchangeably.

14. S.W. Kolhagen, "The Behaviour of Foreign-Exchange Markets--A Critical Survey of the Literature"; and R.M. Levich, "On the Efficiency of Markets for Foreign Exchange".

15. See D.E. Loque and R.J. Sweeney, " 'White Noise' in Imperfect Markets: The Case of the Franc/Dollar Exchange Rate".

16. W.S. Krasker, "The 'Peso Problem' in Testing the Efficiency of Forward Exchange Markets".

17. J.A. Frenkel, "The Forward Exchange Rate, Expectations, and the Demand for Money: the German Hyperinflation".

18. P.M. Garber, "Efficiency in Foreign-Exchange Markets: Interpreting a Common Technique".

19. T.F. Cargill and G.C. Rausser, "Temporal Price Behaviour in Commodity Futures Markets".

20. L.H. Summers, "Do We Really Know That Financial Markets Are Efficient?"

21. J.A. Frankel, "Tests of Rational Expectations in the Foreign-Exchange Market".

22. J.A. Frankel and R.M. Levich, "Transactions Costs and Interest Arbitrage: Tranquil versus Turbulent Periods".

23. R.Z. Aliber, "Monetary Independence Under Floating Exchange Rates"; J. Geweke and E. Feige, "Some Joint Tests of the Efficiency of Markets for Forward Foreign Exchange"; S. Gupta, "A Note on the Efficiency of Black Markets in Foreign Currencies"; D.E. Logue et al., "Speculative Behaviour of Foreign-Exchange Rates During the Current Float"; S.F. Overturf, "Risk, Transactions Charges, and the Market for Foreign-Exchange Services"; and A.C. Stockman, "Risk, Information, and Forward-Exchange Rates".

24. In references to futures markets, the term delivery date will be used to mean the last day of trading, although actual delivery of a currency takes place two days after the last day of trading. Similarly, when a spot or forward contract is made, the actual exchange of currencies usually takes place two days later (on the "value date"). An exception is US dollar-Canadian dollar trading, where the value date is usually the next day.

25. See L.P Hansen and R.J. Hodrick, "Forward-Exchange Rates as Optimal Predictors of Future Spot Rates: An Econometric Analysis".

26. R.M. Levich, "On the Efficiency of Markets for Foreign Exchange".

27. D.B. Panton and O.M. Joy, "Empirical Evidence on International Monetary Market Currency Futures".

28. The non-linearity may indicate that information relevant to forecasting does not arrive at a constant rate. Stockman, in "Risk Information", presented some results that implied a varying rate of information acquisition over time.

29. The system was a set of seemingly unrelated regressions (SUR), so the estimation procedure was generalized least squares (GLS). Since the right-hand side variables were the same for each equation, the SUR estimates were the same as those from ordinary least squares estimation. However, GLS was necessary for the test of joint multimarket efficiency.

30. Geweke and Feige, "Some Joint Tests".

31. Hansen and Hodrick, "Foreign-Exchange Rates"; and C.S. Hakkio, "Expectations and the Forward Exchange Rate".
32. D.A. Glassman, "The Efficiency of Foreign-Exchange Futures Markets in Turbulent and Non-Turbulent Periods".
33. The first indication that the large sample assumption was inappropriate was given by conflicts among the conclusions from Wald, Lagrange, and likelihood ratio tests for joint multimarket efficiency. These three tests are equivalent when the sample size is sufficiently large. Therefore the test statistics reported here have been adjusted with an Edgeworth size correction, which altered some results. See Glassman, "Efficiency of Foreign Exchange", for details.
34. Summers, "Do We Really Know".
35. O.T. Beauchard and M.W. Watson, "Bubbles, Rational Expectations and Financial Markets".
36. J.M. Keynes, The General Theory of Employment, Interest, and Money, pp. 153-55. Keynes added, "it is not sensible to pay 25 for an investment of which you believe the prospective yield to justify a value of 30, if you also believe that the market will value it at 20 three months hence." (p. 155)
37. Friedman, Essays.
38. D. Taylor, "Official Intervention in the Foreign-Exchange Market, or, Bet Against the Central Bank".
39. Ibid.

Table 1: Studies of Foreign-Exchange Market Efficiency

Authors	Currencies	Sample
A. Tests of Unbiasedness		
Frenkel (1977)	GM vs. BP	Monthly 2/21-8/23
Garber (1978)	GM vs. BP	Monthly 2/21-8/23
Krasker (1980)	GM vs. BP	Monthly 2/21-8/23
Frenkel (1978)	GM vs. BP	Monthly 2/21-8/23
Frenkel & Clements (1978)	BP, FF, FF vs. BP	Monthly 2/21-5/25
Levich (1978)	BP, BF, CD, DG, DM, FF, IL, JY, SF	Weekly 1/3/67-5/9/75
Cornell (1977)	BP, CD, DG, GM, JY, SF FF	Monthly 4/73-1/77 Monthly 7/74-1/77
Frankel (1980)	BP, DG, FF, GM, IL, SF	Weekly 1/5/73-4/4/78
Hakkio (1981)	BP, CD, DG, GM, SF	Weekly 4/24/73-5/5/77
Baillie, Lippens & McMahon (1983)	BP, FF, GM, IL CD, SF	Weekly 6/1/73-4/8/80 Weekly 12/1/77-5/15/80
Baillie & McMahon (1982)	BP, GM, IL	Weekly 6/1/73-4/8/80
Jacobs (1982)	BP, CD, FF, GM, IL, JY, SF	Monthly 6/73-11/80 Quarterly 6/73-11/80
Longworth (1981)	CD	Monthly 7/70-12/78
Louberge (1981)	BF, BP, FF, GM, IL, SF, SK BP, SF BF, BP, CD, FF, GM, JY, SF, SK	Monthly 11/78-3/80 Weekly 11/78-3/80 Monthly 1/73-12/78
Panton & Joy (no date)	BP, CD, DG, FF, GM, JY, MP, SF	3,6,9,12 mos. to delivery, 6/18/72-3/16/76

B. Correlation Tests

Hansen & Hodrick (1980)	BP, FF vs. BP, GM vs. BP BP, CD, FF, GM, IL, JY, SF	Weekly 1/21/22-9/1/23 Weekly 10/9/73-1/16/79
Poole (1967)	CD AP, BF, BP, CD, FF, IL, JY, NK, SK	Daily, Weekly 10/4/50-5/2/62 Daily, Weekly 1919-betw. 1924 and 1929 depending on country
Frenkel & Levich (1977)	BP, CD, DM	Weekly 1962-67, 1968-69, 7/73-75
Levich (1978)	BP, BP, CD, DG, FF, GM, IL, JY, SF	Weekly 1/3/67-5/9/75
Geweke & Feige (1979)	BF, BP, CD, DG, FF, GM, SF	Quarterly 1963:3-1967:2.1972: 3-1977:1
Gupta (1981)	IR, SKW, TD	Monthly 1/58-3/76 Weekly 9/7/76-9/18/79
Logue & Sweeney (1977)	FF	Daily 1/70-3/74
Cornell & Dietrich (1978)	BP, CD, DG, GM, JY, SF	Daily 3/73-9/75
Burt, Kaen & Booth (1977)	BP, CD, GM	Daily 4/1/73-4/27/75
Logue, Sweeney & Willet (1978)	BP, DG, FF, GM, IL, JY, SF	Daily 4/1/73-1/7/76
Stockman (1978)	BP, CD, DG, GM, JY, SF	Weekly 2/73-5/77
Huang (1981)	BP, GM, BP vs. GM	Monthly 3/73-3/79

Table 1 (continued)

Authors	Currencies	Sample
C. Tests for Unexploited Profits		
Poole (1967)	CD	Daily, Weekly 10/4/50-5/2/62
	AP, BF, BP, CD, FF, IL, JY, NK, SK	Daily, Weekly 1919-betw. 1924 and 1929 depending on country
Levich (1978)	BF, BP, CD, DG, FF, GM, IL, JY, SF	Weekly 1/3/67-5/9/75
Logue & Sweeney (1977)	FF	Daily 1/70-3/78
Cornell & Dietrich (1978)	BP, CD, DG, GM, JY, SF	Daily 3/73-9/75
Logue, Sweeney & Willet (1978)	BP, DG, FF, GM, IL	Daily 4/1/73-1/7/76
Gupta (1981)	IR, SKW, TD	Monthly 1/58-3/76
		Weekly 9/7/76-9/18/79
D. Variance Bounds Tests		
Huang (1981)	BP, GM, BP vs. GM	Monthly 3/78-3/79

Notes

All exchange rates are versus the US dollar unless otherwise noted.

Currency abbreviations:

AP	Argentine peso	DG	Dutch guilder	IR	Indian rupee	SF	Swiss franc
BF	Belgian franc	FF	French franc	JY	Japanese yen	SK	Swedish krone
BP	British pound	GM	German mark	MP	Mexican peso	SKW	South Korean won
CD	Canadian dollar	IL	Italian lira	NK	Norwegian krone	TD	Taiwanese dollar

Table 2: Trading Periods for Contracts in Sample

	Contract	Period of Trading*	Nobs**
1	September 1972	May 16/72-September 18/72	76
2	December 1972	May 17/72-December 18/72	137
3	March 1973	May 23/72-March 19/73	195
4	June 1973	May 24/72-June 18/73	255
5	September 1973	October 2/72-September 17/73	228
6	December 1973	December 20/72-December 17/73	238
7	March 1974	May 14/73-March 18/74	202
8	June 1974	December 21/73-June 17/74	110
9	September 1974	December 12/73-September 16/74	180
10	December 1974	December 14/73-December 16/74	241
11	March 1975	December 14/73-March 17/75	303
12	June 1975	June 4/74-June 16/75	250
13	September 1975	September 5/74-September 15/75	248
14	December 1975	December 6/74-December 15/75	248
15	March 1976	July 1/75-March 15/76	167
16	June 1976	November 3/75-June 14/76	143
17	September 1976	March 26/76-September 13/76	107
18	December 1976	January 15/76-December 13/76	220
19	March 1977	June 25/76-March 14/77	169
20	June 1977	August 27/76-June 13/77	188
21	September 1977	December 2/76-September 19/77	190
22	December 1977	January 4/77-December 19/77	233
23	March 1978	April 12/77-March 13/78	222
24	June 1978	October 3/77-June 19/78	169
25	September 1978	December 2/77-September 18/78	189
26	December 1978	October 14/77-December 18/78	285
27	March 1979	April 24/78-March 19/79	216
28	June 1979	September 6/78-June 18/79	185
29	September 1979	October 24/78-September 17/79	214
30	December 1979	February 1/79-December 17/79	211

Notes

* Period when all four currencies were traded.

** Number of days in period of trading minus holidays and minus lagged observations for correlation tests.

Table 3: Mean Percentage Forecast Errors (T Ratios in Parentheses)*

No. days to end of trading	British Pound	Canadian Dollar	German Mark	Swiss Franc
20	-0.0031	0.0038	-0.0067	-0.0088
	(-0.8464)	(1.4239)	(-1.5970)	(-1.8225)
19	-0.0024	0.0025	-0.0068	-0.0068
	(-0.6719)	(1.0176)	(-1.7651)	(-1.6030)
18	-0.0007	0.0027	-0.0064	-0.0053
	(-0.1999)	(1.1483)	(-1.6505)	(-1.2669)
17	0.0012	0.0027	-0.0047	-0.0008
	(0.3600)	(1.0104)	(-1.1783)	(-0.1882)
16	-0.0004	0.0012	-0.0055	-0.0043
	(-0.1016)	(0.5651)	(-1.4755)	(-0.9063)
15	-0.0011	0.0008	-0.0042	-0.0074
	(-0.2604)	(0.3088)	(-1.2531)	(-1.5113)
14	-0.0009	0.0014	-0.0052	-0.0036
	(-0.2541)	(0.7601)	(-1.5357)	(-0.8174)
13	0.0001	0.0012	-0.0047	-0.0025
	(0.0379)	(0.6662)	(-1.5006)	(-0.5858)
12	0.0017	0.0014	-0.0047	-0.0001
	(0.4496)	(0.8430)	(-1.4203)	(-0.0307)
11	0.0004	0.0016	-0.0031	-0.0006
	(0.1124)	(1.0910)	(-1.0541)	(-0.1381)
10	-0.0009	0.0007	-0.0025	0.0006
	(-0.2272)	(0.4392)	(-0.7895)	(0.0989)
9	0.0004	0.0003	-0.0022	0.0004
	(0.1302)	(0.2558)	(-1.0755)	(0.0936)
8	0.0004	0.0001	-0.0012	0.0008
	(0.1292)	(0.0863)	(-0.5341)	(0.2024)
7	-0.0002	0.0005	-0.0021	0.0001
	(-0.0573)	(0.5521)	(-0.8431)	(0.0141)
6	-0.0016	0.0000	-0.0028	-0.0014
	(-0.5911)	(0.0211)	(-1.2256)	(-0.4178)
5	-0.0005	0.0002	-0.0023	-0.0006
	(-0.2110)	(0.2146)	(-1.1265)	(-0.2002)
4	0.0004	0.0003	-0.0021	-0.0019
	(0.2068)	(0.3811)	(-1.2806)	(-0.7870)
3	0.0002	0.0003	-0.0024	-0.0023
	(0.1597)	(0.4301)	(-1.5199)	(-1.1841)
2	-0.0001	-0.0000	-0.0024	-0.0020
	(-0.0646)	(-0.0786)	(-1.8911)	(-1.3891)
1	-0.0007	-0.0002	-0.0025	-0.0025
	(-0.8687)	(-0.4166)	(-2.5189)	(-2.3250)

Note

* Percentage forecast error = (spot rate on last day of trading minus futures rate at given number of days before end of trading)/spot rate

Table 4: Correlation Tests of Efficiency

					F Statistics				X^2 Statistics
Contract			Nobs	Df	BP	CD	DM	SF	
1	Sep	1972	76	35	7.973**	1.459	1.042	1.351	310.330**
2	Dec	1972	137	96	3.387**	1.902**	1.575*	1.138	587.620**
3	Mar	1973	195	154	4.402**	2.054**	6.552**	7.201**	465.910**
4	Jun	1973	255	214	1.685*	1.488*	4.083**	2.962**	287.190**
5	Sep	1973	228	187	2.306**	1.915**	2.459**	2.747**	304.390**
6	Dec	1973	238	197	1.758**	1.100	2.456**	2.148**	241.290**
7	Mar	1974	202	161	0.974	1.245	0.921	0.977	176.420
8	Jun	1974	110	69	0.835	1.284	0.512	0.639	139.780
9	Sep	1974	180	139	1.481	0.864	1.613*	0.918	200.270*
10	Dec	1974	241	200	1.802**	0.861	1.392	1.594*	207.160*
11	Mar	1975	303	261	1.058	0.930	0.793	1.272	167.030
12	Jun	1975	250	209	0.772	1.333	1.396	1.490*	218.080**
13	Sep	1975	248	207	1.658*	1.355	1.018	0.721	210.450**
14	Dec	1975	248	207	1.101	1.323	0.791	1.133	195.220*
15	Mar	1976	167	126	1.128	1.503*	1.058	1.579*	206.490*
16	Jun	1976	143	102	1.731*	1.064	1.241	1.147	199.600*
17	Sep	1976	147	66	1.622*	0.763	0.855	0.647	161.230
18	Dec	1976	220	179	0.938	1.356	0.708	0.994	159.310
19	Mar	1977	169	128	0.818	1.239	1.003	0.900	156.560
20	Jun	1977	188	147	0.870	1.199	0.807	0.986	160.750
21	Sep	1977	190	149	1.356	1.418	1.094	1.033	199.330*
22	Dec	1977	233	192	1.956**	1.206	1.632*	1.383	236.870**
23	Mar	1978	222	181	2.222**	0.960	1.922**	1.485*	261.550**
24	Jun	1978	169	128	1.407	0.742	1.298	1.376	194.760
25	Sep	1978	189	148	1.062	1.087	1.205	1.871**	216.820**
26	Dec	1978	285	244	1.032	1.090	1.450*	2.468**	267.750**
27	Mar	1979	216	175	1.087	1.508*	1.556*	2.088**	257.620**
28	Jun	1979	185	144	1.101	1.407	1.614*	1.682*	218.390**
29	Sep	1979	214	173	1.118	0.590	0.667	0.926	174.410
30	Dec	1979	211	170	1.584*	0.720	1.125	1.021	202.280*

Notes

Nobs - number of observations in each regression equation
Df - regression degrees of freedom
* - significant at 5% level
** - significant at 1% level

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9: CANADA, THE INTERNATIONAL MONETARY FUND, AND EXCHANGE-RATE POLICY

John M. Curtis

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CANADA, THE INTERNATIONAL MONETARY FUND, AND EXCHANGE-RATE POLICY

Introduction

A great deal has been written in recent years about the international financial system in general and the IMF in particular, as well as about exchange-rate policy. Little of it, however, has had a Canadian focus. This fact is surprising, given the long and continuous Canadian involvement in the international financial system since its conception and founding towards the end of the Second World War[1] and given the Canadian public's almost daily fixation with the Canada-US exchange rate.

It is doubly surprising that such interest as there was seems to have largely disappeared by the mid-1960s.[2] Whether this apparent decline in interest reflects a general turning away from international subjects in Canada from that time onward is an open question. While some international trade theory and policy analysis has been carried out over the past 20 years in Canada, it has involved relatively few people, has generally focussed on quite specific and theoretical subjects, and often has not been done from a specifically Canadian perspective. Development studies in recent years have probably fared somewhat better; indeed, there are the makings of several centres of strength across Canada.

The same is not true however for international financial work, especially not for work with a strongly public policy and Canadian orientation. While some of the reason for this situation might be ascribed to a diminished interest in international subjects, including international economics, over the past 20 years the fact is that most of the thinking and discussion of international financial subjects has gone on within the federal government and within its central bank, the Bank of Canada.

The Canadian debate, both on international financial policy and institutions and on exchange-rate policy, has therefore been essentially a private one with limited opportunities for outsiders to join in, apart from the occasional economist from a private bank or investment house. The general level of public discussion, to the extent that it exists at all, has not been all that strong and probably will not be until information and analysis becomes much more widely available.

This paper will attempt to begin discussion in this very important area of Canadian public policy by reviewing several of the major financial policy issues of the past decade and by attempting to establish a Canadian perspective concerning them. A first section will provide an overview of the principal developments affecting the IMF since the collapse of the Bretton Woods system between 1971 and 1973. Particular attention will be paid to the growth of private international lending and the corresponding decrease in the role of official lending. A second section will detail Canada's role in the international financial system over the past decade, stressing the continuity of official Canadian policy towards the IMF dating from this country's early involvement in the creation of the organization. A third section will focus more particularly on the relationship between exchange rates and trade policy in light of the institutional changes that have taken place since the early 1970s. Finally, using Canadian involvement in the IMF as the example, Canada's interest in effective international macro-economic, financial, and trade policy co-ordination will be analyzed very briefly.

Recent Developments

While the economic and institutional story of the 1970s and early 1980s, and hence the pressures on multilateral institutions such as the

IMF, is by now well known, several events that occurred during that time are of particular relevance.

One is the breakdown of the fixed exchange-rate system early in the 1970s with the major implications that this change had both for the Fund's role and for its operations. In particular, the Fund's authority over exchange-rate practices--its surveillance role--changed in such a way that there developed far more scope for national decision-making. Notwithstanding the introduction of Article IV of the amended articles in 1978,[3] the Fund's ability to enforce co-ordination of exchange-rate policy, except for those countries on stand-by arrangements, appears under present-day rules to be weaker than it was under the earlier system.

A further and related development in the 1970s, impinging directly on the environment in which the Fund now operates, was the slow erosion of multilateralism as such and of the various post-war institutions that were designed to support it. The Fund, for example, was established with the objective of maintaining a trade, investment, and payments system that was as liberal as possible. Yet even with the successful completion of the GATT Tokyo Round negotiations, it was apparent by the late 1970s that the thrust toward liberalization had, for many reasons, ended. While the impact of this development to date has been far more apparent in the trade and investment fields than in the financial field, the tone and policy attitudes that it created has affected all the multilateral organizations to some extent.

In addition, varying degrees of inflation experienced by different countries, particularly since the first OPEC price shock of 1973, and the policies that countries have taken to cope with it, have affected the environment in which the IMF operates. The late 1970s was the era of monetarism and was characterized in policy terms by an unprecedented ascendency of the world's national central banks. The IMF probably benefited from this overall shift as it tended to reinforce its own practices and its long-standing advice to debtor countries. Still, the world of high inflation, high interest rates, and high unemployment that evolved in the late 1970s and early 1980s was a complicated one. In this environment, the Fund was buffeted by criticism from all sides as were the various national governments implementing highly restrictive policies.

Fourth, what became known as the North-South debate, the discussion of the appropriate economic relationship between developed and developing countries, influenced the international climate as well. Dominating the discussions was an underlying sense that the links which form the basis of the world economy were inequitable, and this prompted much criticism of the Fund and of other western-oriented institutions. Policies advocated or imposed by the Fund were judged by many as being anti-growth and insensitive to the social and political priorities of the developing countries. While the need for adjustment was, for the most part, accepted, the overall line of this argument was that surplus countries should do some of the adjusting and that deficit countries should not be forced to adopt policies inimical to development.

Last, the increase in the activity of the private commercial banks in the international financial intermediation process fundamentally affected the world financial system. In terms of sovereign borrowing, for example, the share accounted for by official agencies such as the IMF and the share accounted for by private organizations reversed themselves between 1970 and 1983.[4] This reversal of roles was caused by many factors: highly liquid OPEC deposits on the one hand and deficits on the part of oil-deficient countries on the other, as well as an increasingly severe shortage of resources available to the IMF. This added an entirely new institutional player--the private bank--to the international financial scene. As the international debt crisis deepened after 1979, especially in the developing countries and to some extent in the Eastern Bloc, new ad hoc negotiating arrangements including the private commercial banks became commonplace in efforts to effect debt postponement and/or re-scheduling.

Canada's Role in the Fund

From the beginning, when Canada participated actively in the building of the post-war multilateral system which included the Fund, the

Canadian position has been one of strong support. During the formative wartime planning years, this country leaned to the American view of a revolving international "fund" of credit to provide short-term balance-of-payments support to restore equilibrium, rather than to the British view of a much larger bank from which capital could be drawn to support economic development. The differing Anglo-American positions quickly evolved over a period of some two years into two separate organizations, the Fund and the World Bank (IBRD), each of which was organized with quite different mandates and time perspectives.[5] Canada appears to have advocated this division of mandate and perspective throughout this period and thus has tended to be on the conservative side of the many development finance issues that arose since 1960.

Yet, as with other aspects of Canadian foreign policy, Canada's position was often slightly more progressive than the mainstream western view. Canadian policies during the 1960s, for example, favoured a decline in the role of the American dollar as a reserve asset. It was argued that the creation of a new international reserve asset, administered internationally under the auspices of the IMF and available to all members, would allow for a more predictable and controlled expansion of international liquidity.[6] The Finance Minister at the time, John N. Turner, illustrated this when he stated in 1972 that "it is of the utmost importance that the momentum of the SDR system be maintained."[7] He added that the role of the US dollar as a reserve currency should not expand and that a system of asset settlement should be attained whereby the SDR would be placed at the centre of the monetary system.[8]

In keeping with this posture, Canada appears to have supported the various steps taken to reduce the official role of gold in the system in the late 1960s and throughout the 1970s:

> The reduction of the role of gold in the international monetary system has been in line with a position which Canada has consistently advocated, and the reduction of the role of gold seems to us a necessary step toward bringing liquidity creation under international control.[9]

Notwithstanding this position, a subsequent Minister of Finance, Donald S. Macdonald, did express concern over the way in which the Fund was to dispose of its gold holdings. While he fully supported the concept of a Trust Fund within the IMF to be financed by such sales, the Minister did direct the Executive Director for Canada at the IMF to ask the Fund to ensure that the gold sales be conducted in such a way as not to disrupt the commercial gold market.[10]

Canada also supported moves to strengthen the role of the SDR, such as reducing the number of currencies making up the SDR basket (although it does not appear to have suggested a reduction to five key currencies, thereby excluding the Canadian dollar) and increasing the interest rate on the SDR to a more attractive level. Similarly, it appears to have supported proposals for a substitution account.[11]

When it comes to defining Canada's position on the use of Fund resources, the evidence is somewhat ambiguous. On the one hand, Canada is often seen as being sympathetic to calls for the IMF to enlarge its resources and to make them more easily available, as in the period prior to the revisions announced in February 1983, for example. On the other hand, Canada often seems inclined to adhere to the orthodox view of the Fund's role held by most industrialized countries.[12]

Plumptre nevertheless argued that Canada has long supported greater participation in the Fund by developing countries.[13] Moreover, at the annual meetings of the Fund, Canada has consistently voiced its concern over the plight of those countries in the wake of the oil crises. While questions of liquidity and reserve assets may have preoccupied the government in the late 1960s and very early 1970s, by 1974 the emphasis clearly was on the effects of the oil shocks, including payments imbalances, "petrodollar" recycling, and economic slowdown. Mr. Turner at that time drew attention to "the crisis to which many developing countries have been brought. . . . The real growth of the poorest of these countries is being reduced to zero or worse. In human terms this means untold suffering. It means deprivation, despair, and starvation."[14] The Minister supported the formation of the Interim Committee as early as 1974 to provide political leadership for the Fund as well as a joint World Bank/IMF Development Committee.[15] In 1975 he referred to Canada's support for the many Fund facilities aimed specifically at the developing world. These included the Oil Facility and the Trust Fund as well as the compensatory financing, buffer stock financing, and extended facilities.[16]

Several subsequent Canadian Ministers of Finance raised the possibility that the Fund's resources might not be adequate to meet the demands placed upon them. In 1979, however, the Minister of Finance, John Crosbie, declared that the Fund's resources were indeed adequate. His address to the annual meeting that year was characterized by a somewhat sterner tone than those of his predecessors.[17] He noted the way in which private sources of capital complement the resources of the Fund and of the World Bank and was of the opinion that no new medium- or long-term financing facilities were required at that time. Moreover, enlarging Fund resources and facilitating access to them might jeopardize the fundamental nature of the Fund, namely as a source of:

> temporary balance of payments support in return for more disciplined economic policies. . . . The value of Fund assistance is to a large extent a function of its ability to ensure that its members implement sound adjustment policies. . . . If there is a continuing balance of payments deficit, then clearly either the wrong sorts of projects are being financed, or the country concerned is trying to expand its economy too rapidly. . . . Continuing balance of payments deficits imply a need for a more fundamental re-examination of economic policy. . . . [S]ome stringent measures of economic self-discipline are required.[18]

While Mr. Crosbie's words might have been blunter than those of other Ministers of Finance, it is not clear that his position was fundamentally at variance with earlier Canadian policy. Ministers of Finance had stated from the time of the Bretton Woods Conference of 1944 that the Fund should not evolve into a development institution. For this reason they had stated unequivocally their opposition to the proposal to "link" future allocations of SDRs to the financial needs of developing countries. For example, six years earlier John Turner had explained:

> We are concerned that such a link might hinder the acceptance of the SDR as the principal asset of the reformed system. We are also apprehensive that such a link might inhibit the establishing and maintaining of control over international liquidity which is essential to reform. Moreover, we are not convinced that such a link would increase the flow of development assistance.[19]

At a somewhat later date, Donald Macdonald also reiterated Canada's rejection of the "link" and underlined the fact that the "IMF has the responsibility basically for the short-term balance-of-payments problems of members, both developed and developing countries."[20] He emphasized that the distinction between the Fund and the Bank should not be blurred. His view was echoed by Jean Chrétien at the Fund's annual meeting in 1977.[21]

More recently, while the government has supported increases in Fund quotas, it has not altered its view of the Fund's role. Fund resources must be adequate to keep the level of international liquidity in step with the value of world trade,[22] but these resources should not necessarily be obtainable at relaxed levels of conditionality.[23] Indeed, "the Fund must be especially cautious in ensuring that it does not create excessive amounts of non-conditional liquidity".[24] While recent economic developments might have necessitated the realignment of individual quotas, any such realignment should take place according to economic criteria.[25] "Clearly, what we need to do is to assure that the resources and the facilities of the Fund are adequate to help members make the necessary adjustments as smoothly and timely as possible".[26] This last statement perhaps summarizes best the overall tone and position of Canada during the tumultuous period of the 1970s and early 1980s.

The Exchange Rate as a Trade Policy Variable: Variations on the Floating vs Intervention Theme

With the breakdown of the Bretton Woods fixed exchange-rate system, the level and, to a lesser extent, the volatility of the exchange rate has become a major international trade issue.[27] In Canada, however, the exchange rate has been recognized as being an important economic policy variable for much longer, although more often implicitly rather than explicitly. As a consequence, it probably affected our practice of breaking the internationally-accepted norm and floating our currency twice: once between 1950 and 1962 and a second time from 1970 on. Perhaps the clearest official enunciation of the trade benefits to be obtained from a lower exchange rate was made by Donald Fleming, the Minister of Finance in the late 1950s and early 1960s. In 1961, he stated:

> An expansion in exports and a reduction in imports should not be brought about by export subsidies, or by higher tariff rates, or quotas, or other forms of government intervention or protection, but rather by encouraging our exchange rate to fall into a more appropriate relationship with our economic situation.[28]

The Bank of Canada vehemently opposed any deliberate devaluation. The dispute between the Bank and the government on this and other issues of economic policy eventually led to the resignation of the Governor, James Coyne. In many respects, the attitude of the Bank does not appear to have changed since then.

The Canadian government position, in contrast, has been more ambiguous. In 1978, Minister of Finance Jean Chrétien stated that, in carrying out its responsibility to exercise surveillance over exchange rates, "the Fund is right to emphasize the view that exchange rates must reflect underlying economic and financial conditions"[29] and, presumably, that they not be manipulated for unilateral gain. As far as Canada was concerned, the federal government's policy was not to defend the dollar's value within any particular range.

> We believe that market forces should continue to determine the appropriate exchange value for our currency. What we are doing, as we have done consistently for the past eight years, is to smooth out erratic fluctuations in the value of the dollar as they occur in the market.[30]

A similar stance was taken by John Crosbie during his tenure as Minister of Finance in 1979-80: "We do not think that government is so omniscient nor the private sector so obtuse that we should impose a particular view on the market."[31] Crosbie also recognized that the costs and benefits of either a higher or a lower dollar would be mixed. Thus, "it seems more sensible to allow market forces to determine where the rate should be and to confine our intervention to allowing that determination to be made in as orderly a way as possible."[32]

Yet the government's commitment to let the dollar go where it will can sometimes be questioned in light of its acknowledgement of the trade benefits that flow from a cheaper dollar. Earlier in 1979, for example, while reiterating the government's policy of allowing the exchange rate to be determined by market forces, Mr. Chrétien conceded that the current account balance had improved as a result of the depreciation of the dollar. He added, "There is no doubt in my mind that the depreciation of the dollar has been extremely beneficial to Canada in terms of increased jobs, increased investment and increased trade."[33] More recently, Marc Lalonde, commenting on the exchange rate, stated that the rate of 81.5 cents US per Canadian dollar in mid-1983 was, "as far as I can assess, a pretty fair value for the Canadian dollar. I am not keen on seeing it running up further."[34] It is difficult to know whether satisfaction with where the dollar is at any particular time implies active government management to keep it there. And that is the critical question.

Nevertheless the Bank of Canada, if not the government, seems particularly sensitive to any attempt to manipulate the exchange market for trade or any other reason such as permitting interest rates to fall significantly below those prevailing in the United States and abroad. In the face of such continuing pressure to permit the value of the Canadian dollar to fall beyond the level at which it had stabilized by 1978 (85 to 86 cents US), the Bank declared for example:

> Even if the Canadian dollar declined sharply in value it would take a long time for that change to have any major effect on the size of the current account deficit. . . . Meanwhile the price level in Canada would have been pushed even higher by the fall in the dollar and unless Canadians were prepared to accept the resulting decline in their living standards, this in turn would lead before long to a further acceleration of the wage-price spiral. . . .[35]

This point about the dangers of depreciation outweighing the trade benefits that might accrue from a lower dollar has been repeated many times in recent years:

> It is because of the substantial inflationary risk involved that I have never favoured depreciation where it could be avoided or at least limited. The record has not been good; our past experience with exchange rate depreciation has been that all too often it has led, not to a sustained improvement in our competitiveness, but to additional inflationary momentum as Canadians attempted to protect their incomes against the loss of purchasing power. The end result has then been more inflation rather than more economic activity.[36]

More generally, the Governor has declared:

> Confidence in exchange markets is just terribly important. . . . If the market ever gets the impression that the authorities are deliberately trying to engineer some decline in the exchange rate, you had better watch out. . . . [T]he exchange markets are very delicate, and one had better be very careful.[37]

The Bank thus maintains the position that it does not stand in the way of the market, except to "smooth out" fluctuations in the movements of the exchange rate and to prevent over- or under-shooting.

> The Bank of Canada has not wanted these interest rate increases nor has it wanted to see a lower Canadian dollar. What the Bank could do in these circumstances was to try to moderate the pressures on Canadian interest rates and on our exchange rate, and that is what we have done. Had we taken stronger action to forestall the rise in our interest rates, the initial burden of adjustment to the external situation would have fallen still more on the exchange value of the Canadian dollar. Alternatively, greater resistance to exchange-rate depreciation would have required still higher Canadian interest rates than we now have.[38]

Yet in spite of Mr. Bouey's protests that the Bank does not adhere to any particular target range for the exchange rate, it seems clear that its over-riding policy objective in recent years has been to prevent substantial depreciation of the dollar.

> If we have a 1 per cent drop in the exchange rate of the Canadian dollar, prices of imports will go up immediately. . . . Even Canadian exporters are not going to sell to Canadians for less than what they sell abroad. If you add those things up you can come to a ballpark figure of .3.

> So the fall of the 1 per cent in the exchange rate causes our prices to go up by .3, given the weighting of those particular goods in the system. . . . Then people try to pass on these increased costs, and in a period where. . .inflationary expectations are high, they will obviously try to do that.[39]

Canadian policy-makers could attempt to ignore the inflationary consequences of allowing a depreciation to occur by not keeping relative, real interest rates high enough. One would then be on a slippery slope. In Mr. Bouey's words:

> We could do what some other countries have done, just say that maybe we will just give in. We would force our interests rates down and let the exchange rate go as far as it would go, and in a year or two we would have a 20 per cent inflation rate, or 25 per cent. Israel over 100 per cent; Argentina has been up to 700 per cent. That is a route one could go.[40]

International Policy Co-ordination

As a relatively small, open and peculiarly dependent economy, Canada has always had a strong interest in effective international policy co-ordination. Where this co-operation has become institutionalized, Canada has always attempted to join the club.[41] This country's position in this respect has generally been two-tracked: to actively promote international discussion and negotiation generally on an institutional basis while simultaneously playing the underactive or passive role, as the fixer of the international system. These two objectives are not necessarily inconsistent: in ensuring a strong multilateral system, rather than pursuing a system of bilateralism based more on power than on law, Canada can at least partially escape the embrace of its overwhelming neighbour, the United States. Simultaneously, however, and especially in view of the long-term, secular decline of US preponderence in economic affairs, Canada's position also appears to have been to ensure that the United States is not isolated. While Canadian views on economic subjects might go beyond or fall short of the US position at any one time, the basic Canadian position will have as its pole the American position.

Perhaps nowhere is this truer than in the case of Canada's role in the IMF, as outlined above. While more or less supporting basic

American positions--such as those concerning the IMF and the international financial system in general with its emphasis on the market system, the decline in the role of gold, the creation of the SDR, and low and high conditionality--Canada's attitudes and most importantly its practices have nevertheless deviated somewhat from the orthodox US and Fund positions. Canadian views on the float, on exchange-rate systems, on adjustment expectations concerning debtors, particularly LDC debtors, on the expansion of existing financing facilities or the creation of new ones, or more recently the size of desirable Fund quota increases and access to Fund resources have differed to some degree from those of the United States and in many cases from those of other western countries.

Conclusion

On the basis of the very limited public information available, it appears that in the post-war era Canada has consistently supported the liberal multilateralism that the IMF represents. Nevertheless, Canadian governments have broken the Fund rules when it suited them and in so doing have proved that Canada is a rather normal international actor.

While sectoral or regional arrangements might have some appeal on the goods-and-services side of things, it seems clear that--given the level of capital market integration world-wide and particularly the level of integration between Canada and the United States and the overall benefits of this interdependence--Canada has opted unambiguously for a multilateral role in this area. The costs of other arrangements and the benefits of the existing one are such that this overall approach will probably characterize Canadian public policy for some time to come. But a widening of the debate to include more actors in our society, from other departments of the federal government to other governments and private sector interests within Canada, such as academics with a strong public policy and institutional bent, might be useful, either to confirm the basic wisdom of present Canadian policy or to suggest alternative policy choices by which the national interest might be even better served.

Notes

1. Well documented in A.F.W. Plumptre, *Three Decades of Decision: Canada and the World Monetary System, 1944-75.*
2. P. Wonnacott, *The Floating Canadian Dollar: Exchange Flexibility and Monetary Independence*, was the last major piece on the subject and is still much quoted.
3. Empowering the Fund under Section 3(a) to "oversee the international monetary system in order to ensure its effective operation, and to oversee the compliance of each member with its obligations under Section 1 of this Article", and under article (b) to "exercise firm surveillance over the exchange rate policies of members, and to adopt specific principles for the guidance of all members with respect to those policies. Each member shall provide the Fund with the information necessary for such surveillance, and, when requested by the Fund, shall consult with it on the member's exchange rate policies. The principles adopted by the Fund shall be consistent with cooperative arrangements by which members maintain the value of their currencies in relation to the value of the currency or currencies of other members, as well as with other exchange arrangements of a member's choice consistent with the purposes of the Fund and Section 1 of this Article. These principles shall respect the domestic social and political policies of members, and in applying these principles the Fund shall pay due regard to the circumstances of members." See *Articles of Agreement of the International Monetary Fund*, 8.
4. Using private lending levels as the base, official lending as a percentage of private lending fell from 1970 to 1983, as follows:

   Official Lending As a Percentage of Private Lending

1970	1980	1981	1982	1983
122.0%	62.8%	58.1%	57.6%	55.4%

   (Derived from International Bank for Reconstruction and Development, *World Debt Tables 1983-84*.)
5. With the development of the Fund's special facilities or "windows" for borrowing in the 1970s and the Bank's Special

Adjustment Program (SAP) in 1980, the line between the two organizations now seems a little less clear than it did from 1944 until the late 1970s.

6. See Plumptre, Three Decades of Decision, 195-7.
7. John N. Turner, in IMF Summary Proceedings of the Twenty-Seventh Annual Meeting (September 1972), 146.
8. Ibid., 145.
9. Donald S. Macdonald, Hansard, 24 May 1977, 5889.
10. Donald S. Macdonald, IMF Summary Proceedings of the Thirty-First Annual Meeting (October 1976), 37. Canada, after all, is the world's largest producer of gold.
11. Allan J. MacEachen, Address to the Interim Committee of the IMF, Hamburg, 25 April 1980, 3. The dollar substitution account initiative was a central feature of the IMF Interim Committee's efforts to restructure the international monetary system. By allowing central banks to deposit dollars and other currencies in SDR-denominated (Special Drawing Right) accounts with the IMF, it was hoped that the substitution account would, "promote the role of the SDR 'as the principal reserve asset' and. . .remove an additional element of instability from currency markets and exchange rates", (R. Pringle, "Mapping over the Role of an IMF Substitution Account"), 23. However, at the Interim Committee's annual meeting in 1980, the substitution account initiative was postponed, if not indefinitely suspended. The current strength of the US dollar, itself a reflection of confidence in the role of the dollar as the world's reserve currency, suggests that the initiative will not attract much attention in the near future.
12. This ambiguity of position is reflected quite clearly in the remarks made by Michael Wilson, Minister of Finance, to the 1984 annual IMF/IBRD meeting:

    > I think we all agree that enlarged access has permitted the Fund to make a valuable contribution to the process of adjustment. While the world economy has improved considerably since 1982, the highly uncertain current situation suggests that the policy should be continued for

> another year. At the same time, I recognize that enlarged access is a temporary measure and should be gradually phased down. I welcome the agreement reached in the Interim Committee for its contribution to each of these goals.
> The other major item on the Fund side is the question of an allocation of SDRs. Relevant to our consideration of this issue is the rebound in world trade and the consequent prospect of an expansion in the overall demand for official reserves. The global need for reserves can likely be met in forms other than the SDR. However, in support of the objective of strengthening the role of the SDR in the international monetary system, it would be appropriate if we were to satisfy some of that need through modest SDR allocations. I regret that we have not been able to find a consensus on this matter."

(From " Notes for Remarks by the Honourable Michael Wilson, Minister of Finance for Canada, to the Joint Annual Meeting of the International Monetary Fund and World Bank", Washington D.C., 24 September 1984, (Department of Finance Release 84-142), 6.

13. Plumptre, Three Decades of Decision, 197.

14. John N. Turner, IMF Summary Proceedings of the Twenty-Ninth Annual Meeting (September/October 1974), 179. The role of the Interim Committee has evolved since 1974 to include the management and implementation of initiatives aimed at restructuring the international monetary system and includes a surveillance role over IMF members. Though this latter role is purely advisory, the Interim Committee is compact and representative enough to take meaningful decisions.

    The membership of the Interim Committee is composed of Finance Ministers and Central Bank Governors, 20 of whom are drawn from the same country constituencies as the Executive Board of the IMF. Canada has been a prominent member of the Interim Committee, representing the Canadian/Irish/Caribbean constituency.

15. Ibid., 180-81.

16. John N. Turner, IMF Summary Proceedings of the Thirtieth Annual Meeting (September 1975), 133.

17. See John Crosbie, IMF Summary Proceedings of the Thirty-Fourth Annual Meeting (October 1979), 87-9.
18. Ibid., 88-9.
19. John N. Turner, Hansard, 15 October 1973, 6821.
20. Donald S. Macdonald, Hansard, 25 May 1977, 5940.
21. Jean Chrétien, IMF Summary Proceedings of the Thirty-Second Annual Meeting (September 1977), 116.
22. Pierre Bussières, Hansard, 13 June 1980, 2106.
23. Ian Stewart, House of Commons Standing Committee on Finance, Trade, and Economic Affairs, Proceedings; Issue No. 18, 10 July 1980, 7.
24. "Text of Statements issued by Deputy Prime Minister and Minister of Finance Allan J. MacEachen at the Annual Meeting of Commonwealth Finance Ministers", Nassau, 22 September 1981, 4.
25. Ibid.
26. Ibid., 3.
27. One of the best contemporary pieces of analysis is found in R. Blackhurst and J. Tumlir, Trade Relations under Flexible Exchange Rates.
28. Quoted in Plumptre, Three Decades of Decision, 165.
29. Jean Chrétien, IMF Summary Proceedings of the Thirty-Third Annual Meeting (September 1978), 160.
30. Jean Chrétien, Address to the Montreal Canadian Club, 1.
31. John Crosbie, "A Canadian View of the Canadian Dollar", 7.
32. Ibid., 8.
33. Jean Chrétien, Address to the Council on Foreign Relations, 9.
34. Marc Lalonde, "The Views of Canada's Finance Chief".
35. Gerald K. Bouey, in House of Commons Standing Committee on Finance, Trade, and Economic Affairs, Proceedings, Issue No. 2, 25 October 1979, 11.
36. Gerald K. Bouey, Luncheon Address to a Meeting of the Board of Directors of the Bank of Canada, 4-5.
37. Gerald K. Bouey, in Senate Standing Committee on National Finance, Proceedings, Issue No. 35, 26 May 1981, 25.

38. Gerald K. Bouey, Luncheon Address, 4-5.

39. Gerald K. Bouey, in House of Commons Standing Committee on Finance, Trade, and Economic Affairs, Proceedings, Issue No. 68, 25 March 1982, 41.

40. Ibid., 36.

41. The most notable instances are the Canadian desire to be included in the western economic summits from the second summit in 1976 onward and later the quadilateral trade meetings, as well as the more recent Canadian wish to have greater access to the workings of the so-called G-5 (France, Germany, Japan, United Kingdom and the United States), who meet twice a year to discuss international exchange rates and economic performance.

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10: OFFICIAL EXPORT FINANCING: A CANADIAN LEGAL PERSPECTIVE

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OFFICIAL EXPORT FINANCING: A CANADIAN LEGAL PERSPECTIVE

Introduction

In the last two decades, competition for export markets has occurred in conjunction with increased official financial assistance from governments. This paper begins by examining the legal format of such financial assistance in Canada, as provided by the Export Development Corporation (EDC). The history of official export finance is then surveyed, and the unique OECD consensus is examined and its weaknesses are discussed. The GATT rules on subsidies, as they relate to official export credits, are then surveyed, together with the legal problems arising out of the application of the new GATT Subsidies Code. Finally, the countervailing duty laws of Canada and the United States are discussed, with particular reference to the recent application of the latter against EDC financial assistance in the Bombardier case.

Export Financing and the Export Development Corporation

An official export financing scheme in Canada was originally provided under the terms of the Export Credits Insurance Act 1944.[1] Since 1969, the scheme has been carried out by the EDC, a corporation created under the Export Development Act.[2] This Act establishes the EDC as a federal agency, designed to facilitate and develop trade between Canada and other countries.[3] In addition to the provision of export credits insurance and guarantees, this facilitation of trade may take the form of financial assistance where such assistance is necessary to complete a transaction.[4] This is not normally the course of action if financing on similar terms is available in the private market or if the proposed transaction does not meet EDC criteria and guidelines.

The authority of the EDC to lend money in support of export transactions is set out in sections 29 through 33 of the Act. While the corporation is not available for all transactions, the EDC has nevertheless become a prime source of funds for exporters who are unable to get support in the private capital markets. Similarly, the EDC may become involved when necessary to insure the participation of private lenders.

Although the Act establishes the general framework for the implementation of lending in support of export transactions, it does not set out a detailed set of principles for the acceptance or rejection of any given proposal or project. This power is a discretionary one, which has been delegated to the board of directors of the corporation under the Act.[5] Over the years, the EDC has implemented various lending schemes and facilities and has established the criteria upon which a transaction will be considered for support under such schemes. The Act is flexible enough to allow the EDC to make judgments and exercise discretion in pursuing its mandate in much the same way as would a commercial bank--and that, indeed, is how the EDC prefers to view itself.

It is necessary, however, that a transaction meet certain basic criteria. Section 29 of the Act states that the board, in authorizing a transaction, must do so for the purpose of facilitating and developing trade between Canada and any foreign country. This is a neutral mandate which could embrace both economic and political considerations. The ambiguity is partly resolved by the EDC practice of requiring a loan to be acceptable on criteria derived from traditional banking analysis and commercial principles. The corporation has expressed its position thus: "The overall mandate of the EDC is to promote and facilitate export trade. In pursuing this objective, EDC encourages export business based on sound commercial practices and providing long lasting benefits to Canada."[6]

The phrase "long lasting benefits to Canada" is a key one, since consideration of purely commercial factors might, under certain conditions, lead to the elimination of the EDC itself. Political factors are indeed relevant but such factors are domestic in nature.

The EDC's annual report for 1981 states: "An objective of the corporation in pursuing its purpose is to conduct its affairs in accordance with commercial principles and disciplines and to maintain the Corporation in a sound financial condition."[7]

Section 29(1)(a) of the Act permits the EDC to lend money to a "foreign customer" in respect of an "export transaction" on the security of an "instrument". Section 23 of the Act defines these expressions. The definitions themselves are extremely broad, the general tenor of the Act being to leave the discretion of the corporation relatively unimpaired within its lending limits.

A "foreign customer" is defined as a person carrying on business or other activities outside Canada, with whom the corporation or other person carrying on business or other activities in Canada has dealings; a foreign government may be included in this defintion.[8] Because a foreign customer may carry on "other activities", such as in the fields of education, health, infrastructure development, public utilities or perhaps even recreation, these are not excluded from EDC support. The interpretation of "other activities" is probably as wide as the corporation chooses to make it.

An "export transaction" is also broadly defined and is taken to mean a transaction involving:

- the export of goods out of Canada;
- the manufacture, treatment or servicing of goods for, or the sale or leasing of goods to, a foreign customer;
- the sale or licencing of any right in a patent, trademark or copyright to a foreign customer; or
- the rendering to a foreign customer of any managerial, construction, technological, marketing or other services; or
- the purchase of goods in Canada for use outside Canada.[9]

The programs developed by the EDC reflect its mandate to assist in the export of services as well as goods. Goods are defined in section 23 of the Act as being "goods, wares and merchandise" as defined under the Bank Act.[10] The effect of this definition is to enable the EDC support to range over a variety of commodities, from raw resources to finished capital equipment. When combined with the definition of export transaction, full turn-key projects with attendant licencing and technology may qualify for consideration.

Section 29(1)(a) does require that the corporation lend money only on the strength of an "instrument", which may be a promissory note, bill of exchange or other negotiable instrument payable by a foreign customer or a bond, debenture or other evidence of indebtedness issued or given by a foreign customer, including an agreement to pay.[11] The Act does not specify the type or rank of security that the corporation must obtain for its loans in any given situation.[12]

Section 29(1)(b) of the Act permits the EDC to guarantee payment of an instrument given, made or accepted by a foreign customer respecting an export transaction. Section 29(1)(e) permits the EDC to agree to purchase an instrument or interest in an instrument issued to a person by a foreign customer with respect to a loan to be made by that person, or to sell to a person an instrument or an interest in an instrument issued to the corporation by a foreign customer with respect to a loan to be made by the corporation. This section authorizes supplier credits to be used as a form of financing export sales.

The corporation's power to lend under section 29 is limited by a monetary ceiling, measured in Canadian dollars, which has been increased from time to time.[13] This limit is an aggregate of all transactions outstanding at any time under section 29 and includes foreign principal repayment obligations under loans made and potential liability of foreign customers under written agreements entered into by the corporation, but as yet unexecuted. The limit under the Export Development Act of 1969 was $600 million, which was to include any outstanding loans of the forerunner Act, the Export Credits Insurance Act.[14] The current ceiling is set at an amount that is ten times the authorized capital of the corporation.[15] Section 11(1) of the Act now states that the authorized capital of the corporation is \$1.5 billion and the ceiling is therefore \$15 billion. As of 31 December 1982, the corporation had lent only \$7.754 billion.[16]

A further lending opportunity lies with the corporation. Under certain circumstances it may be authorized by the federal Cabinet to make a particular loan which it might not otherwise undertake. This situation is provided for in section 31 of the Act and loans in this category are referred to by the EDC as being on "Canada account", as opposed to section 29 loans which are on the corporation's own account. Monies required for such loans are provided to the corporation by the Minister of Finance from the Consolidated Revenue fund and are accounted for separately by the corporation. All receipts and recoveries that the corporation makes on such loans are paid to the Receiver General of Canada, with the exception of funds required to cover expenses and overhead that have arisen as a result of such loans. Such funds do not, therefore, become part of the working capital of the corporation and are not available for use in other areas of its operation. In effect then, the EDC is merely managing such loans on behalf of the federal government and is acting as the government's arm in carrying out such projects by supplying the necessary expertise.

This lending procedure is available when the Minister thinks it is in the national interest that a loan or loan guarantee be made or given. The proposed loan or loan guarantee must exceed in its amount or term the normal level of the corporation, and would not therefore normally be made by the EDC.[17] The Minister must then report to Cabinet, which may then authorize the EDC to make the loan. The "national interest" is, of course, not defined so that the discretion of the Minister and ultimately of Cabinet is unfettered. The national interest could conceivably include the creation of jobs, the saving of a failing industry in Canada, or the maintenance of trading relations at a particular level with a particular country or region. The issues are not so much legal as they are practical political issues and, as such, they may be either purely domestic or international in nature. This section, in effect, gives the government a further foreign aid tool.

Section 32 sets the limit for loans and guarantees on these Canada account matters at Cdn. $6 billion. This includes liability under loans made and loans which the EDC has agreed to make. It is interesting to note that the section refers to loans only in terms of setting the ceiling, although section 31 permits the making of loans and the issuing of guarantees. Prior to its amendment, section 31 provided for a $200 million ceiling on the "liability of foreign customers under all outstanding instruments accepted by the Corporation or guaranteed by it pursuant to section 31".[18] As of 31 December 1982, the position of the EDC as against the $6 billion limit was $1,435 billion. This compares to $743,302 million at 31 December 1981.[19]

In recent years, the EDC has been under substantial pressure due to its limited assets as well as to increases in the cost of money. One attempt to increase the coverage of the corporation was the development of parallel financing in conjunction with the Canadian International Development Agency (CIDA).[20] The commercial and developmental aspects of these financing arrangements have to qualify separately under the criteria of each agency. Since the aid segment of these financings is a separate and distinct element, the overall financing package is not seen as involving Canada in a breach of the OECD Arrangement of Export Credits.[21] Sometimes other financial institutions like the World Bank participate in these financings.

In 1981, Canada responded to pressure from other exporters, such as France and the United Kingdom, and the EDC offered "credit-mixte" in ostensible compliance with the OECD Arrangement. The EDC introduced a $900 million fund to provide subsidized financing to match foreign loans. Under the scheme, $600 million in conventional lending was combined with $300 million in direct government subsidy. One loan falling under this category was the financing in 1981 of sales of subway cars by Bombardier Inc. to Mexico. Though Canada claims the scheme is compatible with the OECD Arrangement, individual loans under the facility might violate its terms (for example, if they are not for development aid purposes).

Canadian Export Financing Facilities

No two instances of government involvement in export financing are identical. Each case responds to the needs of exporters in particular countries and banking environments. Nonetheless, because all major exporters are competing for identical markets, it is not surprising that a degree of uniformity in practices has emerged.

The OECD Arrangement requires a cash payment of at least 15 per cent of the contract value by purchasers of exported goods and services. The Arrangement further states: "Participants will not provide official support for such cash payments other than insurance and guarantees against the usual pre-credit risks."[22]

This means that official export financing will not exceed 85 per cent of the value of the contract in a given export transaction. There is no statutory guideline to this effect in Canada to limit the EDC. The EDC does, however, adopt an 85 per cent ceiling. Such financing may be provided by way of either "buyer" or "supplier" credits. These types of credits describe variations of the financing transactions that permit a supplier to be paid quickly, but at the same time facilitate the transaction in a manner suited to the buyer's ability to pay.

A "supplier credit" is defined as "an arrangement under which a supplier agreed to allow deferred payment by his customer of the financed amount of the contract".[23] Supplier credits are normally used in short-term and medium-term transactions.[24] Despite this, the seller will want to obtain his money as soon as possible. The buyer's obligation is evidenced by a series of notes or bills of exchange issued to the seller. The seller may be able to arrange for the factoring, acceptance or discounting of these notes through his bank and thereby obtain early payment, while extending the payment period for the foreign buyer.[25] In this situation there is no direct financial arrangement between the buyer and the discounting bank, so a greater degree of recourse is likely to be maintained by the bank in such cases.

A "buyer credit" involves the negotiation of a specific loan between the buyer and the lender either in the buyer's or the seller's country. Under some schemes, lenders in both countries may be involved. The funds which the buyer receives are then used by him in making payment for the goods to the seller. The buyer is also obligated to the lender pursuant to the loan agreement. A buyer credit is, therefore, similar to a supplier credit that has been discounted by the supplier on a "without recourse" basis. The seller has been paid and a credit risk is carried by the bank. Under this arrangement, the obligations of the parties to the commercial agreement for the purchase and sale of goods are separate and distinct from the responsibility of the parties under the loan agreement. The loan is usually drawn down and paid directly by the lender to the supplier once the supplier provides documented proof to the lender that the terms of the loan agreement and commercial contract have been complied with, and the supplier is thereby entitled to payment. Because of the distinction made between the loan agreement and the commercial contract, complex arrangements are required, in the supplier country, to document the obligations of supplier, lender and government agency.

It is important to keep in mind that the risks involved in an export transaction may be different and less measurable by the methods normally employed in domestic transactions. The lender may face both commercial and political risks. While he is called upon to evaluate the commercial risk (or the ability and willingness of the buyer to pay) just as in a domestic transaction, the tools available to assess that risk may not exist or, if they do exist, they may not be as reliable or as up to date as they are in his own country. In addition, the lender must consider the political risks. Does the buyer have access to the currency in which the loan is to be funded? Is expropriation a danger? Is the host nation stable and, if not, is there risk that repayment will not be made in the event of a civil war or revolution? The true magnitude of such risks is now evident in light of the widely published reports of repayment difficulties of countries such as Mexico, Brazil, and Poland.[26]

The methods by which governments involve themselves in export financing transactions vary from country to country. The government agency may involve itself by directly funding buyer or supplier credits, thus making the financing available. On the other hand, governments may operate in a less overt manner by providing guarantees and other conditions that make it easy for a vigorous domestic financial market to supply the necessary funds. Or, the government may intervene as a subsidizer by affecting the cost of borrowing: "Such intervention has typically started as a smoothing operation converting variable rate funding to a fixed rate which is expected to reflect some medium level over the credit period of the cost of funds."[27]

In recent years, relatively high domestic rates and keen competition for export contracts have driven interest rates down on such export transactions, and the amount of the subsidy has been greater and, as has been pointed out, a spiral has developed from which escape is difficult.[28]

With the exception of subsidization, all of the roles played by governments in this area could be performed by agencies in the private sector. The extent to which government agencies and the private sector are involved varies from country to country, although it is probably fair to say that there is some level of government involvement in every country and the tendency seems to be toward an increase in this activity.

In July 1981, the Royal Bank of Canada submitted a proposal to the Canadian government outlining an alternative system for the provision of official export credits. This proposal was recast in February 1983.[29]

The revised proposal argues for the involvement of the chartered banks in EDC-arranged export credits, based on the very low level of such involvement at present and the size and sophistication of the large Canadian banks. Under the proposal, the private banks would handle applications for officially-supported loans. Once the EDC approved the loan it would reimburse the bank for the difference between the banks' margin and the officially approved lending rate. While it is difficult to take issue with the banks' arguments that they can service and monitor export financing as well as or even better than a government agency, it is clear that they would not be prepared to lend at rates comparable to those available from the EDC. Furthermore, the transaction costs for the chartered banks might be too high in Canada for pooling arrangements to be practicable.

In Canada, the EDC offers six types of financing facilities, which include both buyer and supplier credit arrangements. Buyer credit arrangements are in the form of:

- loans, usually for repayment over terms in excess of five years with fixed or floating interest rates. Agreement for disbursement of funds direct to the seller is possible.
- multiple disbursement loan agreements that permit several exporters to receive payment pursuant to a multiple agreement.
- lines of credit, both confirmed and unconfirmed. These are important financing tools. At the end of 1982, 15 confirmed and three unconfirmed lines were in place. This was an increase of six confirmed lines and one unconfirmed line since 1980. This facility, which is established with public and private agencies and banks abroad, is intended to encourage foreign buyers to consider Canadian products. At the same time, lines of credit remove uncertainty as to the term and rate and establish a defined disbursement procedure. A confirmed line of credit is evidenced by a signed loan agreement between the EDC and the borrowing agency in the foreign country. Funds allotted to the line are then available to buyers of Canadian goods in that country on the terms established in the loan agreement, providing the transaction and buyer meet the criteria established in the loan agreement. Unconfirmed lines of credit are subject only to a general agreement to lend, with the specific terms to be established under a loan agreement negotiated at the time the party resorts to that line of credit.[30]

EDC supplier credits take the form of:

- a note purchase, which may be negotiated by a seller with the EDC. In this instance, a note purchase agreement is concluded and may or may not provide for recourse and may or may not be guaranteed by a bank.

- a forfeiting facility. On short-term, small- and medium-sized transactions, the EDC will purchase, without recourse, a series of promissory notes, drawn by foreign banks for Canadian goods and payable to Canadian exporters and guaranteed by a bank acceptable to the EDC. Where the transaction meets EDC requirements and criteria, and where the exporter is prepared to accept deferred payment of up to 85 per cent of the transaction and can find a first-class financial institution prepared to guarantee the notes, this service is appropriate. The service has the advantage of allowing the buyer to pay off the debt in his own currency. From the seller's point of view, interest and exchange-rate fluctuations are eliminated, as are transfer problems and political and credit risks.
- private bank participation in export credit transactions. EDC policy is to encourage and actively seek such participation, which may take the form of EDC loan guarantees to financial institutions providing funds to buyers of Canadian goods, subject to normal EDC criteria for acceptance of the transaction. Such participation may also take the form of co-lending, parallel loans or participation in previously negotiated loans.[31]

Canadian exports that are supported by official export credits extended by the EDC are subject to Canadian content guidelines. Although not specifically provided for in the legislation, these guidelines apparently reflect the EDC's efforts to expand trade between Canada and other countries. Canadian content is defined by the EDC as "the proportion of the value of goods and services exported which is spent and retained in Canada and therefore creates or maintains employment in Canada". Consequently, the export of goods from a Canadian address does not necessarily indicate 100 per cent Canadian content because this would depend on the extent to which payment for those goods was retained in Canada.[32]

Under the EDC Guidelines, in addition to commercial and other criteria used to evaluate an export credit proposal, domestic content is also considered under a scheme which comprises three levels. A "threshold level" is the minimum level required to be considered for EDC support and is usually set at 60 per cent Canadian content in the contract price. Once an application is accepted, the EDC will attempt to direct exporters to Canadian component suppliers with a view to raising Canadian content. In recent years this contract level has averaged at about 80 per cent. The EDC monitors these levels through reporting requirements and audits.[33]

In foreign direct investment projects, the formal requirements regarding Canadian content are sometimes applied more sensitively. Minimum ratios that apply to ordinary export transactions might be modified in recognition of the importance of other factors, such as the development of foreign markets and foreign-exchange earnings.[34]

History of Official Export Finance

The years immediately following the World War Two saw a dramatic increase in the volume and dollar value of international trade. The vast industrial capabilities developed in the wartime United States led the way, but these were soon followed by the re-emerging European and Japanese economies. Recent years have also seen the emergence of certain developing nations as important industrial and trading nations. Examples are Korea, Argentina, Brazil, Mexico and some of countries of the Association of Southeast Asia Nations (ASEAN). Among these nations, the industrial sectors have become economically significant, and altered demographic patterns have placed many more workers from the farms and countryside in the industrial cities. Improved and quicker transportation methods have opened the products of these economies to a much wider variety of consumers all over the world. In particular, in the years following World War Two we have seen the developing countries become markets of increasing importance for the products of the industrialized nations.

Within the economies of the industrial nations, the manufacturing and service sectors have taken on an even more important role in the last thirty or forty years. The health and vigour of these sectors has consequently become a matter of national interest. With few exceptions these nations are not capable of achieving continuously high rates of economic growth purely on the strength of their domestic markets. To provide the economies of scale and for other reasons, foreign markets were expanded and, in looking abroad, suppliers were forced to look as well at factors that are not as significant in their domestic markets. These include less predictable commercial and political risks and, as international trade is developed, increased foreign competition.

Having developed the industrial sectors and foreign markets and facing greater competition in those markets and in the winning of new markets, the industrial nations quickly found themselves searching for new methods and means to win contracts and defeat competition. With the post-war expansion in world trade, pricing and export financing arrangements became increasingly important as competitive elements in the winning of contracts. In addition, the extremely large dollar value of contracts--such as turn-key plant or resource development projects--became a factor, and costs of credit became a significant part of the overall cost. The official export credit programs in the exporting countries began to develop to meet this financial need, given that in most countries the markets may not have internalized all the relevant benefits and costs.[35] Governments or government agencies entered the picture in order to assist their nationals in obtaining contracts.[36]

Competition in credit terms became keen, and differing philosophies as to the importance of the export sectors and the propriety of competition based on credit terms, as well as differing economic and financial structures from country to country, resulted in a polarizing of positions concerning officially supported export credits.[37] Generally speaking, the North American countries, principally the United States, took the view that an extreme level of government involvement was not proper, that it was not consistent with historical development in those countries and that competition should be based on quality, service and price.[38]

Other nations--particularly European countries--were prepared to subsidize exports extensively. This was not, of course, because private lenders could not, in theory, furnish loans but because these governments were prepared to lend at less-than-market rates in order to secure sales for their export industries. This in turn created difficulties for industries in countries whose governments were reluctant to interfere with market forces but were under political pressure to do so.

A special group of industrialized countries (most notably Japan, West Germany and Switzerland) have domestic interest rates that are unusally low by world standards. Like the United States, Japan favours reduced official export subsidization, but mainly because of its commitment to industrial growth through exports and not because it shares the conviction of the United States as to the merit of the free market. Because its rates are only marginally better than those available commercially, Japan is considered an unaggressive participant in official export financing.

By the early 1970s, it became evident that some form of stabilization was required in the export credit field. The OECD countries began negotiating towards this end and in 1976 a consensus was achieved.[39] Further negotiation resulted in the concluding of the OECD Arrangement on Guidelines for Officially Supported Export Credits in 1978.[40] The conclusion of the Arrangement was seen by the United States as a step towards the reduction or elimination of export subsidies and by the Europeans as an agreement on the terms of a tolerable practice. Comparison of the Arrangement with the earlier consensus supports the latter view, in that it represented a comprehensive and uniform document, rather than a collection of separate declarations.[41]

Since the conclusion of the Arrangement, participants have conferred on a regular basis to try to find a more acceptable format, but have only partially succeeded.[42] It was generally felt that the fixed interest rate and term matrix does not take account of varied terms and interest rates in the domestic markets of the participants. Further, it did not account for the varied exchange rates, and consequently it places some participants at a disadvantage. In 1978, the cost to OECD countries of official support for interest rates was estimated to be over $2 billion and by 1980 it was estimated as exceeding $5.5 billion.[43] The Arrangement has merely provided a framework for continuing negotiations and agreements on refinement of rates to meet current conditions. Meanwhile, the need for a new scheme or format to replace the current Arrangement persists. Despite this, the Arrangement has reduced competition, particularly where interest rates and credit lengths are concerned, and continues to have a salutary, though uncertain, influence over national export credit practices.

The most significant contribution to the debate with respect to the alternatives was supplied in May 1980, when the report of Mr. Wallen (later chairman of the OECD Export Credits Group) was delivered to the OECD.[44] Axel Wallen had been commissioned by the OECD in January 1979 to examine alternatives to the present arrangement. The Wallen Report concluded that subsidies of interest rates distort the natural patterns of trade and artificially and detrimentally support particular sectors of the domestic economy both absolutely ("structural adjustment may be impeded if the industry benefiting from the subsidy becomes dependent on it") and relatively ("as costs are increased for parts of the economy which do not benefit from subsidization, resources are artificially maintained in sectors which are less efficient by international standards").[45]

In his report, Wallen set out two principal alternatives to the present system. The first--the Uniform Moving Matrix--retains the present system of uniform interest rates, but incorporates periodic adjustments to reflect changes in weighted average market rates for the currencies of participants. This system ensures greater uniformity, but does not eliminate the element of subsidy in countries where market rates exceed the average. More controversial is the Differential Rate System, which eliminates the subsidy element, but sets a different minimum rate for each currency, related to its market rate, from which a uniform margin of subsidy is deducted. Like the first proposal, this system only addresses interest rates and does not suggest changes to other sections of the Arrangement.

In October 1983, a new agreement was reached by all Arrangement members (except, initially, Canada) regarding interest rates under the OECD Arrangement. Canada agreed to the new procedures in November 1983, but registered its objection both to their content and to the process by which they were implemented. Under the new agreement on interest rates, minimum rates are to fluctuate in accordance with market rates (as measured by the yields in secondary markets for medium-term government bonds) for the five weighted SDR currencies (Special Drawing Rights). If a change of more than 50 base points occurs within six months, minimum rates will also incorporate such changes. The introduction of this shifting matrix was accompanied by immediate cuts in minimum rates. These cuts are to be restored in a series of steps over a three-year period. The overall result will be that in 1986 the matrix rates will bear the same relationship to the SDR as they did at the date of the new agreement. The new matrix goes substantially towards meeting US concerns that rate minimums be brought more into line with market realities. The Wallen Report proposed (lower) cost of funds to governments. Nevertheless, the new interest rate matrix substantially represents an amalgamation of Wallen's two alternative systems--a differentiated system with provision for adjustment in accordance with market rates.

It should be pointed out that the Arrangement was not the first example of an international effort to co-ordinate subsidized export credit activity. In 1934, what is now called the International Union of Credit and Investment Insurers was formed in Berne, Switzerland, and it continues to function today.[46] Popularly known as the Berne Union, it includes as members both government agencies and private insurers and in the early 1950s it established parameters for credit terms. However, the increasing pressures in international markets and the Union's status as an association principally of credit insurers limited its usefulness as a regulator. At the same time, the Union was hampered by Japan's absence from its membership. The Union continues to play a useful technical role and members communicate regularly under Union auspices on an informal basis. The Secretary

General of the Berne Union attends meetings of the OECD Export Credits Group as an observer. Occasionally the OECD looks to the Union for specialized assistance. An example of such Union contribution was the adoption by the OECD of the Union's definition of the "starting point" in contracts for the sale of heavy capital goods.[47]

The Berne Union has been useful in restraining intergovernmental conflict over matters concerning export credits through its moral authority and expertise. Nevertheless, despite the fact that its members are government departments or corporations of various kinds or have government support, they belong to the Union as members in their own right and do not take up national positions. This explains why there was a need for an intergovernmental organization like the OECD to deal with the crucial issue of agreement on credit terms. Historically, the Union has concerned itself not with export financing directly, but rather as its name reflects, with export credit and investment insurance.

A more recent development has been the formation or proposed formation of regional or multilateral export credit facilities. A regional scheme already in place is Banco Latinamericano de Exportaciones (BLADEX) based in Panama City, which provides export financing for the Latin American region.[48] Perhaps the best known of these, however, is the proposed UNCTAD Export Credit Guarantee Facility, which would provide a discounting facility for the export finance agencies of developing countries.[49] The scheme envisages that the facility would guarantee medium- and long-term credits extended by developing countries to other developing countries to improve the marketability of promissory notes held by exporting member countries. Such a guarantee would allow the discounting of such notes in the capital markets at better rates than would be offered for unguaranteed notes. The net result should be a narrowing of the gap between the costs of export finance for developing, as distinct from developed, exporting countries. This scheme presents many practical difficulties related to risk assumption by the facility and the relationship of the facility to other multilateral financial institutions, such as the World Bank.

The OECD Arrangement on Guidelines for Officially Supported Export Credits

The 1978 OECD Arrangements apply to "officially supported export credits" with repayment terms in excess of two years.[50] The Arrangement describes itself as an "informal Arrangement" and takes the form of guidelines. It is not in the form of a treaty and has not been formally signed by the participants. Those participating countries have unilaterally agreed, however, to adhere to the guidelines contained in the Arrangement.

The Arrangement does not define the term "officially supported export credits". In practice, the phrase is understood by parties to the Arrangement to mean any official lending to which the provisions of the Arrangement apply. The Arrangement often makes use of the phrase "official support" to describe lending that is subject to its terms. West Germany and Switzerland offer credit guarantees and are referred to as "pure cover" countries. Their facilities are not subject to the interest rate provisions of the Arrangement.

The Arrangement requires at least 15 per cent of the contract value to be paid by "cash payments at or before the starting point".[51] Starting point is defined in paragraph 11(5) of the Arrangement and has several meanings depending on the type and nature of the project and the goods to be supplied. The cash portion is not to be financed by the participant as an official export credit but can be provided in the form of local costs support. Thus, a maximum of 100 per cent of the price may, in fact, be officially supported. Paragraph 5 of the Arrangement implements an earlier OECD Declaration of 1975 excluding official support for local costs associated with an exporter's contract, but not payable to the exporter.

The Arrangement provides for borrowing countries to be classified as "Relatively Rich", "Intermediate" and "Relatively Poor".[52] For each classification, a maximum repayment term is set and minimum nominal interest rates applicable to various repayment terms up to the maximum are also set. Repayment of principal of an export credit will normally be by equal and regular instalments, at least every six months, with the first payment to be due within six months of the starting point.[53]

Over the years since the Arrangement was concluded, the participants have continued to meet regularly to review and alter, if necessary, the figures in the matrix and to alter the classification of various countries where appropriate.[54]

Paragraph 8 of the Arrangement is intended to place responsibility on the participating countries to ensure that the terms set out in the matrix are "the most generous credit terms for which participants in general intend to give official support". The fear was that such terms would become the norm and to some extent this fear has materialized. Paragraph 8(b) provides, in effect, that where customary terms which are less generous than the Arrangement terms apply to a given sector, then the participants will continue to apply the customary terms.

Toward this end, the Arrangement includes a procedure whereby other participants must be notifed about the terms that participants intend to apply to an official credit.[55] Under this scheme, other participants must advise their terms within seven days or be assumed to apply the most favourable terms permitted under the Arrangement.

Further, the Arrangement provides a procedure to be followed where a participant intends to support transactions on terms that do not conform to its guidelines. In such cases, the party intending to abrogate must notify other participants of its intended terms at least ten calendar days before issuing a commitment. Other participants may then request discussion to take place. If discussion results in the modification of the abrogating terms, then all participants shall be notified.[56]

If no discussion is requested or if discussion fails to produce a withdrawal of the offending terms, then at that point any participant may match the non-conforming terms (but otherwise conform to the guidelines). In addition, any participant shall then have the right to support, with respect to other support prompted by the initial abrogation, any other non-conforming element of the terms, provided that the responding participant introduces a fresh abrogation. This will result in a five-day notification period.[57]

The provisions for notification and abrogation also apply to a participant in the Arrangement who intends to meet non-conforming terms offered by a non-participant.[58] A similar notification and abrogation procedure applies where a participant intends to abrogate from the guidelines with respect to the term of repayment to relatively rich countries, the repayment of principal and interest, tied aid credits and the term of repayment for conventional power plants.[59] Since October 1982, certain forms of abrogation--those involving credit length, interest rates and mixed credits with a grant element of less than 20 per cent--have been prohibited.

The Arrangement does not apply to military equipment, agricultural commodities, aircraft, nuclear power plants or ships covered by the OECD Understanding on Export Credits for Ships.[60] The Arrangement applies, with exceptions, to conventional power plants, ground satellite communication stations and ships not covered by the OECD Understanding on Export Credits for Ships.[61]

Despite its legal and political fragility, the Arrangement has been the major force in stabilizing competition in export credits, albeit at a high level of subsidization. This latter feature may explain the small number of abrogations. An inherent weakness of the Arrangement has been the tendency to view the minimum interest rates it establishes as de facto maximum rates.

The debate over the future of government loans and support of exports revolves around the future of the Arrangement and the differing philosophies of the participants.

> It seems that the export credit pattern established in the mid to late 70s will not survive. The current debate has highlighted certain differences of opinion amongst the OECD countries about the desirability of maintaining a system of fixed and subsidized medium-term export credits as a key feature of the capital goods trade.[62]

The United States wants the Arrangement to be seen as a developmental instrument, perhaps a first step toward a scheme that ultimately emphasizes the quality of the product rather than the convenience of financing.[63] The United States sometimes argues that cheap loans lead the developing world to take on ill-conceived projects. Further, such governmental support is alleged to provide artificial, and therefore dangerous, protection for certain sectors. Europeans, on the other hand, seem more content with the Arrangement in its present form and are hesitant to change it.

This conclusion is based, in part, on recent developments respecting the Arrangement. In October 1981, it was agreed among Arrangement participants that if a country's domestic interest rates are well below Arrangement rates then that country will be able to offer officially-supported export credits at rates below Arrangement levels.

This issue arose because of the very low domestic rates that prevailed in Japan at a time when rates in other OECD countries were generally higher.[64] Recently, many export agencies have expanded the currencies in which they denominate loans. This has become a competitive act because buyers find it advantageous to have their debts set in the same currency as their income, and flexibility in marketing and pricing for the supplier is made available. For example, in addition to lending in Canadian dollars, Canada's Export Development Corporation offers loans in eight other currencies. The most frequently loaned foreign currency, however, remains the US dollar, since it is an international currency.

In addition to these pressures, other pressures on the system suggest an uncertain future for the Arrangement. These additional pressures include:

- the debate over proper classification of countries as rich, intermediate and poor;
- an increased emphasis on private-sector financing techniques, arising out of complications due to the interrelationship of currency and interest rate structures (such as SWAP financing);
- the development of alternatives to circumvent the increasingly tight controls introduced by the Arrangement; and
- the growing list of currencies (presently the Japanese yen, the German mark, the Swiss franc and the Dutch guilder)

that are outside the terms of the Arrangement.

As an example, there is the growth of mixed credits, which match loan funds with aid monies to produce a blended rate intended to be lower than the competition. The Arrangement does not presently control aid monies where the subsidy element exceeds 25 per cent of the export value.[65] As consensus rates come more into line with commercial interest rates, countries may increasingly use their aid budget to secure major export orders.[66] This poses a serious risk, as not only would it distort competition but it would also provoke increased subsidization.

As the world economy stands at present, the political and economic importance of maintaining jobs at home may lead governments to continue with high levels of official involvement in export credits, despite the budgetary difficulties that this creates. Perhaps a return to more prosperous times with a renewed and vigorous financial sector will see a relaxation of government involvement and an emphasis on an "essentially market based export finance system".[67] On the other hand, cyclical fluctuations do not undermine the microeconomic problems that led to government-subsidized export financing in the first place.

Mr. John M. Duff of Eximbank recently considered the issues surrounding the linking of official export credits with political issues in the recipient country.[68] Such issues as human rights and the environment were of interest in the Carter years. Other issues, such as the political situation in the buyer country or the effect in political terms of a particular transaction in the exporting country, are included in the formula from time to time. Certain countries that rely less on export markets, the United States in particular, might view the linkage with political issues as more significant in certain circumstances than would other countries more intent on obtaining the contract. It is interesting to consider that the United States seeks a free-market system with little government involvement in the financing side, but is still prepared to be interventionist where the issues suit it. Canada, on the other hand, like most other countries, shows no such tendency towards political linkages.

Export Credits and the General Agreement on Tariffs and Trade

The General Agreement on Tariffs and Trade (GATT) restricts the use of export subsidies pursuant to article XVI. Signatories agree to report all subsidies that increase exports or decrease imports. Article XVI(3) provides that signatories agree not to use export subsidies in sales of primary products where doing so would inequitably distort world trade in that product. Article XVI(4) in turn provides that no export subsidies are to be used in the sale of non-primary goods that sets export prices below the domestic price.[69]

Further details with respect to subsidies and the application of article XVI of the GATT are set out in the Subsidies Code concluded at the Tokyo Round of the multi-national trade negotiations of 1979.[70] Article 9(1) states: "Signatories shall not grant export subsidies on products other than certain primary products". The Subsidies Code therefore dispenses with the dual pricing requirement for export subsidies set out in article XVI(4) of the GATT. Article 9(2) states: "The practices listed in points (a) to (l) in the Annex are illustrative of export subsidies". Sub-paragraph (k) of the Annex is the relevant provision respecting export credits. In summary, it provides that official export credits provided at rates below those the lending government had to pay for the funds so employed, or payment by the government of all or part of the costs incurred by the exporter in obtaining credits "in so far as they are used to secure a material advantage in the field of export credit terms", are subsidies. On this basis export credits are prohibited under the GATT Subsidies Code.

However, credits offered by governments that are participants in the Arrangement appear to be protected by an exception, which also appears in paragraph (k) of the Annex:

> Provided, however, that if a signatory is a party to an international undertaking of official export credits to which at least twelve original signatories to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original signatories), or if in practice a signatory applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

The effect of this provision is the subject of varying interpretations by Code signatories. It would seem to be clear enough that an "export credit practice which is in conformity with" the Arrangement is not in violation of article 9, but Canada and the United States take the view that such a practice could still constitute a subsidy under other provisions of the Subsidies Code and perhaps support countervailing measures. They contend that such a situation would arise if an export credit was offered at an interest rate in excess of the minimum rate specified in the Arrangement, but at a rate that is less than the cost to the lending government of the loaned funds. The European view is that such an interpretation undermines the purpose of item (k) and that the proper interpretation of the Code is to not regard any Arrangement conforming credits as a subsidy.

Another, more technical issue on which states differ concerns the measurement of the amount of subsidization. Canada regards the amount of the subsidy as the difference between the cost of the funds to the lender and the amount charged the borrower. The United States, on the other hand, takes a more radical view of subsidization, which measures the so called "benefit to the recipient" or the difference between the cost of the funds to the borrower and what he would have paid for them on the private lending market. The EEC would only face this problem of measurement if it were to find that an export credit was not in conformity with the Arrangement and thus violated article 9 as a result. In such a case, the EEC would probably agree with the Canadian approach to measuring subsidization.

The wording of the proviso suggests other problems of interpretation as well. The words "in conformity with" are not clear. It might be argued that a derogation from the guideline matrix interest rates is not in conformity with the Arrangement, even if all of the provisions for notification and consultation are followed. In other words, does the fulfilment of these obligations neutralize a abrogation and produce the conformity the provision requires? Another problem concerns abrogations from the interest rate guidelines that are specifically provided for in the Arrangement (such as matching). Are conforming abrogations of this type part of the "interest rate provisions" conformity protected by item (k)?

What are the options available under the Arrangement to countries that feel aggrieved by the use of an officially-supported export credit? It would appear that legal remedies are limited, if not entirely non-existent. The Arrangement provides only for notification and abrogation procedures, without any form of penalty for abrogation. In fact, the Arrangement legitimizes official export credits by providing a framework within which they are to be used. Further, the Arrangement is only in effect among participating countries and, under the scheme, the only practical sanction, if it can be called that, is the right of a country to match a abrogation if it can afford to do so.

The Subsidies Code does not specifically supersede or replace the GATT rules respecting subsidies and therefore it might be argued that signatories to the Subsidies Code have not waived the right to complain under GATT rules about an Arrangement participant's activity.[71] Furthermore, under article XXIII a GATT member can suspend concessions when benefits accruing to it under the General Agreement are being "nullified or impaired", even if the detriment does not result from a specific violation of the General Agreement. On the other hand, it might be argued that a signatory to the Subsidies Code must be taken to have implicitly accepted the legitimacy of the Arrangement by reason of the item (k) exception and to have waived his right to complain about activities that are legitimate under item (k).[72]

This latter position might not be unreasonable when it is a complaint of a Subsidies Code signatory against a participant that is in question, but surely a non-signatory to the Subsidies Code is not precluded from his GATT remedies for an article VI(4) violation whether that violation is by an Arrangement participant or not. It would seem unfair to impose such a result on a party which has not even implicitly accepted the legitimacy of the Arrangement by adopting the Subsidies Code. Further, such a result would create an absurdity because it would render the GATT provisions useless. No one would ever be able to rely on them, because the existence of the Subsidies Code would always be a defence.

Countervailing Duties and Export Credits

Canada

The remedies set out above, if indeed that is what they are, are only available to states and cannot be initiated by individuals or corporations. Only national governments have standing. Citizens or aggrieved entities are left to the domestic legal framework for remedies if their national governments are not prepared to press an issue. In Canada, this domestic legal framework is markedly deficient. The Customs Tariff Act, together with the Countervailing Duty Regulations promulgated under it, provide for the imposition of countervailing duties to offset subsidies by foreign government on imports into Canada.[73] The Act does not clearly define what subsidy means and the relevance of the GATT Subsidies Code in Canadian law is obscure.[74]

The Countervailing Duty Regulations establish a procedure similar to that followed in respect of anti-dumping duties. Investigations into subsidization are initiated by the Deputy Minister of National Revenue for Customs and Excise upon his being satisfied that goods are being subsidized, and that the subsidy is prima facie likely to cause or is actually causing material injury to Canadian producers of similar goods. Such an investigation may commence on the basis of written complaints by or on behalf of Canadian producers. If the deputy minister is satisfied that a subsidy is present, he makes a preliminary determination of subsidization and notifies his minister. The latter then applies to cabinet for a declaration or provisional countervailing duty and for a reference to the Anti-dumping Tribunal on the issue of injury.[75] If the tribunal finds material injury, the minister applies to cabinet for a declaration that the goods are subject to duty. Thus, in Canada, the imposition of duties ultimately turns on the discretion of cabinet. Unlike anti-dumping duties, which are mandatory once the tribunal makes its determinations, the imposition of countervailing duties turn on the whim of cabinet, free from judicial review.

Countervailing procedures have, in practice, been rarely initiated in Canada though it appears that domestic industries have often attempted to convince the deputy minister to act on their behalf.[76] This reluctance on the part of the government may reflect its uncertainty about the relationship of the new Subsidies Code to the GATT provisions on subsidies. In a large part, the reluctance and uncertainty are due to the fact that the requisite procedures for investigating subsidization have only been in place seven years. By contrast, the United States makes frequent use of its countervail legislation to respond to foreign measures.

On 28 June 1984, the Special Import Measures Act received Royal Assent, but remains unproclaimed.[77] Under the new Act, Canadian countervailing and anti-dumping duty law is combined, with injury determinations being made by a newly-established Canadian Import Tribunal. The new law represents the implementation of Canada's obligations under the various codes that emerged out of the Tokyo Round of Multilateral Trade Negotiations--including the Subsidies Code.

Under the new law, countervailing duties will be imposed following tribunal determinations of injury (though Cabinet will be empowered to exempt goods from the application of the Act).[78] The present requirement that subsidized goods be of a class of kind produced in Canada (not a prerequisite for the imposition of anti-dumping duties) is also dropped so as to allow for the protection of new Canadian industrialization.[79]

As a party to the Subsidies Code, Canada is obliged to consult with countries against whom subsidization is alleged before countervailing duty investigations may commence. Many states, but most notably the EEC countries, rely on price undertakings given by the government of the exporter. A major development in the new law is the introduction of a procedure for the Department of National Revenue to accept price undertakings in both dumping and countervail cases.[80] These provisions are consistent with article 4 of the Subsidies Code, which provides for the termination of countervail proceedings where the exporting country has undertaken to limit subsidies or the exporter has undertaken to revise its prices so as to eliminate the injurious effect of the subsidy. The Special Import Measures Act defines "undertaking", in the case of subsidized goods, as meaning an undertaking or undertakings with respect to goods that are the subject of a subsidizing investigation under the Act, given in writing to the deputy minister:

> (i)...by an exporter who accounts for, or undertakings given individually by exporters who account for, all or substantially all the exports to Canada of the subsidized goods, where the exporter or each exporter, as the case may be,
>
> (A) has the consent of the government of the country of export of the goods to give the undertaking, and
>
> (B) undertakes to revise, in the manner specified in his undertaking, the price at which he sells the goods to importers in Canada, or
>
> (ii) . . .by the governments of countries that account for, all or substantially all the exports to Canada of the subsidized goods where the country or each country, as the case may be, undertakes in its undertaking
>
> (A) to eliminate the subsidy on goods exported to Canada from that country,
>
> (B) to limit the amount of the subsidy on goods exported to Canada from that country,
>
> (C) to limit the quantity of the goods to be exported to Canada from that country, or
>
> (D) otherwise to eliminate the effect of the subsidizing on the production in Canada of like goods,
>
> in the manner specified in its undertaking.[81]

The undertakings so given are intergovernmental in nature and could raise interesting international legal issues. In practice, they would represent a kind of settlement of the subsidy issue, and one that avoids the assessment of duties. Undertakings promise greater flexibility and efficiency in the application of the new law. The responsibility for accepting and monitoring undertakings would lie with the Customs and Excise Division of the Department of National Revenue.

The deputy minister can only accept an undertaking if he or she is of the view that it will either eliminate the subsidy or material injury (that is, that the price of the goods will increase).[82] The deputy minister cannot accept a price undertaking if he or she thinks its administration would be impracticable.[83] To facilitate such surveillance, undertakings as to price and quantity would contain provisions requiring exporters to provide sufficient data to permit effective monitoring. The Act provides for "notice of the acceptance of the undertaking" to be published.[84] At this point, the Special Import Measures Act gives the deputy minister power to resume an investigation in cases where undertakings are violated.[85] The scope of this power is presumably limited by the need for the changes to bear some material relationship to the content of the undertaking. It is hard to see how this provision could be of use to private commercial interests if the terms of undertakings remain secret. This is another unfortunate example of unwillingness on the part of the Canadian government to provide for greater transparency in the administration of our trade laws. In its report on the draft law, a House of Commons sub-committee recommended that there be increased disclosure to the public of information collected during subsidy and anti-dumping investigations, as well as disclosure of the reasoning on which administrative decisions were based.[86]

Under the new Special Import Measures Act, there continues to be no definition of the material injury requirement. This appears to be because the new Subsidies Code does not define material injury either. The Act will however incorporate a reference to the definition of "domestic industry" in the Subsidies Code.[87] In respect of injury inquiries for the purpose of imposing countervailing duties, the new law deems material injury to include any increased financial burdens on agricultural support programs brought about by the subsidization of agricultural imports.[88]

One of the greatest limitations of an effective countervailing duty system is the "third country" problem, when Canadian goods are uncompetitive in a foreign market due to subsidized imports into that market from other countries. The Special Import Measures Act contains a broadly-phrased provision allowing quotas, surtaxes, and duties on the suspension of trade agreements as responses to acts that adversely affect Canadian trade.[89] This provision is broad enough to whose subsidized exports are prejudicing Canadian trade into a third market. Such actions will presumably only occur if authorization is obtained from the Committee on Subsidies and Countervailing Measures set up under the Subsidies Code.

United States

United States law presents a more structured and formalized system for dealing with private complaints about foreign export credits in breach of US domestic or international law.

There are two statutory procedures. First, domestic interests and the Department of Commerce can commence countervailing duty proceedings under the Tariff Act of 1930 with respect to subsidized imports into the United States.[90] These proceedings are similar to those followed in Canada, with subsidization being determined by the International Trade Administration (a division of the Department of Commerce) and injury being determined by the International Trade Commission (formerly the Tariff Commission). Second, Section 301 of the Trade Act of 1974 establishes a procedure for petitioning the President to take action, particularly in cases where a foreign state is in violation of an international agreement.[91] These two procedures represent a procedural separation of the mandatory and discretionary elements that are blended together in the Canadian legal process.[92]

In a recent case, the US Department of Commerce ruled on the question of whether financing provided by Canada's EDC was a subsidy under the Tariff Act.[93] The case arose when a US producer of railcars (the Budd Company) complained that a Canadian competitor (Bombardier Inc. of Montreal) had inter alia, received subsidies within the meaning of the Tariff Act in the form of export credit financing from the EDC. A contract between Bombardier Ltd. and its US customer (the Metropolitan Transportation Authority of New York) specified that EDC would finance up to 85 per cent of the contract price (up to $750 million) at 9.7 per cent for a term of up to 15 years.

The definition of subsidy in the Tariff Act is a long-standing one in US law, but now includes any export subsidy defined in the Annex to the GATT Subsidies Code.[94] One might assume this to mean that an official export credit in conformity with the OECD Arrangement allow countervailing duties against imports from a particular country (which the support given to Bombardier Ltd. was not) is outside the Tariff Act due to the wording of item (k) in the Subsidies Code Annex. The US Department of Commerce, however, takes the view that the exemption set out in item (k) applies only with respect to the enforcement of the Subsidies Code itself and that US law, by virtue of having incorporated the Code's list of export subsidies, includes all export credits at below-market rates.[95]

The Bombardier case was unusual in at least two respects. First, it represented a countervailing duty dispute between two countries whose policy positions on the subject of export credits have, over time, seemed relatively similar. Second, the particular transaction was only actionable under the Tariff Act because it involved exports into the United States. Most export credits that prejudice US commercial interest relate to exports to third countries, where US firms are competing for sales.[96] In the Bombardier case, the real cause of the problem was France, whose subsidized bid on the same contract led to the establishment of the EDC level of financing.

The Bombardier determination establishes that the US Department of Commerce views official export credit financings at preferential rates as a direct or indirect subsidy that is subject to countervailing duties, assuming material injury is also proven. Five different elements of the EDC package were found to constitute a possible governmental subsidy of economic benefit to Bombardier Ltd. These were as follows:

- The Transit Authority's opportunity to finance at 9.7 per cent had an intrinsic value, since interest rates commercially available at the time were higher than the EDC interest rate offer.
- The Transit Authority's ability to use or not use the fixed rate EDC financing throughout the contract performance period, regardless of future interest rates, added an option value.
- The commitment of the EDC to make up to $750 million available for the purchase (regardless of interest rate) had

a value which was reflected in the commitment fee charged by the EDC.

- The EDC's assumption of the cost of interest charges that Bombardier Ltd. would have incurred to obtain comparable financing also had a value.
- A financing arrangement denominated in US dollars had a potential value in that it could expose the financing arrangement to a foreign exchange risk which is assumed by the EDC on behalf of Bombardier Ltd.

Much of the preliminary and final determination in the Bombardier case involved computing the amount of the subsidy. The Transit Authority argued that the EDC financing should be measured against the benchmark established by the OECD Arrangement (11.25 per cent in this case). This raised the issue of the significance of the Arrangement in US law and, consistent with its earlier view, the Department of Commerce rejected the relevance of the Arrangement in its preliminary determination. Since the EDC financing was not seen as complying with Arrangement rates, the International Trade Administration, in its final determination, found it unnecessary to deal with this issue.

The Transit Authority also argued that the EDC financing was a legitimate attempt under article 6 of the Arrangement to match a "prior commitment" offered by France in abrogation of the Arrangement. The final determination rejected this argument on the basis that merely because the Arrangement sanctioned the practice of matching, it did not mean that matching finance was still not in breach of its terms.[97]

The Bombardier case is of special interest for its unequivocal finding that official export credits constitute subsidies under US countervailing duty law. This conclusion is probably valid in Canada as well, given the substantial similarity of our laws. What this means is that if such credits are to survive retaliation they will need enlarged legitimacy in international law over and above that provided by the OECD Arrangement.

The US Department of Commerce interpretations of both the

OECD Arrangement and the GATT Subsidies Code are not binding in international law, though both closely reflect the negotiating position of the United States at the Tokyo Round. Insofar as they reject the relevance of the Arrangement in US domestic law and enlarge the situations where countervailing duties can be imposed, the US interpretations reduce the effectiveness of both international agreements.[98]

Conclusion

In the short term, declining interest rates have removed some of the pressure for increased official export subsidies. This may have facilitated the recent agreement on interest rate ceilings within the framework of the OECD Arrangement. This temporary state of affairs cannot, however, be expected to end the practice of resorting to competitive subsidization in the efforts to penetrate export markets. As the EDC is required by law to operate as a profitable venture, it has been limited in the level of subsidized financing it has been able to provide to borrowers. This legal limitation is reinforced by Canada's special economic relationship of interdependence with the United States. It is probably the combination of these factors that has generally prevented Canada from subsidizing at the level of some of its European competitors and has resulted in Canada being seen as aligned with the United States in the international arena. While Canadian industry lacks the competitiveness of its US counterpart, there is the counter-pressure to grant financing on more liberal terms than in the United States. This, in turn, increases the risk of retaliation. Until now, Canadian subsidization has usually taken the form of repayment terms in breach of the OECD Arrangement and repayment terms longer than those offered by Eximbank. An evaluation of EDC lending practices is difficult. A study prepared for the Economic Council of Canada commented:

> Unlike all other countries that announce and publish their rates on export credits, the EDC treats its interest policy as a state secret. Even after the fact, it does not publish statistical or historical information. This case is probably unique in the world. Although Canada's chartered banks

> are required by legislation going back to the last century to publish such details on a weekly basis, the EDC has established the detestable and unacceptable tradition of keeping this basic information confidential.[99]

The Bombardier case is a timely example of many of the above difficulties. Just as the recent US challenge to Canada's Foreign Investment Review Act in the GATT highlights the paucity of international means to resolve investment disputes between states, the Bombardier case shows the lack of such international facilities in the case of disagreements between nations over financial policies.[100] Bombardier provides striking evidence of increased US willingness to attack what it sees as countervailable subsidies. It was fortuitous that the United States was able to use its countervailing duty legislation in that particular case, because the goods were imported by a US buyer. Even if this private law avenue had been unavailable, the United States indicated that it recognized the greater effectiveness of GATT procedures over any relief available at the OECD. But the selection of a domestic legal solution excluded consideration of the actions of the culprit nation--France (whose subsidized credits in breach of the Arrangement Canada had matched).

The GATT law on subsidies originated prior to the OECD consensus of 1976. Despite the presence of the Subsidies Code, there is still considerable disagreement between countries about what a subsidy is and how countervailing duties are to be measured. The relationship between the specialized OECD Arrangement on Officially Supported Export Credits and the law of the GATT remains uncertain. An observer from a capital goods-importing nation could be excused if he were to characterize the OECD Arrangement as an international cartel amongst the industrialized countries that increases the prices of their exports to importing countries. Certainly the specialized membership of the OECD suggests that the GATT might be a better forum to resolve the dilemma of official export financing by the developed countries. The OECD Arrangements lack effective sanctions and do not provide for institutionalized dispute resolution procedures for its members. Perhaps the best possibility is some kind of revamping of the GATT Subsidies Code to deal specifically with the problem of increased subsidization of export financing.

The Bombardier case signals increased US willingness to countervail Canadian goods that have received export financing. The United States appears unwilling to regard either the Arrangement or the Subsidies Code as restraining its ability to impose countervailing duties in such circumstances. For Canada, the obvious response is to reciprocate in kind, but we appear more reluctant than the United States to ignore our international responsibilities in this manner.

Notes

1. S.C. 1944-45, c.39, as amended.
2. Export Development Act, R.S.C. 1970, c. E-18, as amended.
3. Ibid., s. 10, as amended.
4. See Chen, "Canadian Export Credits, Guarantee and Insurance Programs" in Studies in Canadian Business Law, edited by G. Fridman (Toronto: Butterworths, 1971), 368; Charles E. O'Connor, "Payment and Financing Mechanisms in International Trade and the Role of the Canadian Export Development Corporation" in New Dimensions in International Trade Law: A Canadian Perspective edited by Ziegel and Graham, pp. 58-82, (Toronto: Butterworths, 1980); and Michel Vennat, "Obtaining the Assistance of the Export Development Corporation" in New Developments in the Law of Export Sales John E.C. Bierley (DeBoo, 1982), 86.
5. Export Development Act, R.S.C. 1970, s. 19.
6. EDC Information Circular 81-1 (rev'd. September 1982).
7. Export Development Corporation, Annual Report 1981, 4. For a detailed analysis of an EDC loan see Miller, Olewiler and Richardson, "Cerro Colorado: A Case Study of the Role of Canadian Crown Corporations in Foreign Mineral Development", Working Paper No. 13, Centre for Resource Studies, Queen's University (1978).
8. Export Development Act, R.S.C. 1970, s. 23, as amended. Thus EDC services are available to foreign corporations or individuals

so long as they carry on business in Canada.

9. *Ibid.*
10. *Bank Act*, S.C. 1980, c. 40, defines "goods, wares and merchandise" broadly as including "products of agriculture, products of the forest, products of the quarry and mine, products of the sea, lakes and rivers and all other articles of commerce". See ss. 2(1) and 2(2)(a).
11. *Export Development Act*, R.S.C. 1970, s. 23.
12. *Ibid.*, s. 10(1), as amended.
13. *Ibid.*, s. 30(1), as amended.
14. *Export Development Act*, S.C. 1968-69, c. 39, s. 30.
15. *Export Development Act*, R.S.C. 1970, s. 30(1), as amended.
16. See Export Development Corporation *Annual Report 1982*, 28.
17. *Export Development Act*, R.S.C. 1970, s. 31, as amended by the *Export Development Amendment Act 1983*, S.C. c. 110, s. 17.
18. *Ibid.*, s. 31(1), as amended.
19. *Export Development Act*, S.C. 1968-69, c. 39, s. 30.
20. Export Development Corporation *Annual Report 1982*, 36.
21. See *Arrangement on Guidelines for Official Supported Export Credits*, adopted 22 February 1978, OECD Doc. TD/Consensus/78.4 (1st Revision, 1978).
22. See K.C. Dhawan, "Financing Canadian Exports" in *International Business; A Canadian Perspective*, edited by K.C. Dhawan et al., (Don Mills Ont.: Addison-Wesley, 1981), 660, at 665.
23. *Arrangement on Guidelines*, para. 1.
24. Dunn and Knight, *Export Finance* (Euromoney Publications, 1982), 9.
25. See R.S. Randall, "Export Financing and the Role of the Export Import Bank of the United States" (1976), 11 *J. Int'l L. and Econ.* 91, at 92.
26. Dunn and Knight, *Export Finance*, 10.
27. Of course, EDC offers other facilities, besides financing, to assist exporters against some of these risks. In particular, EDC provides export credits insurance and foreign investment insurance against political risks (war, expropriation, etc.). See

T. Meron, Investment Insurance in International Law (Oceana-Sijthoff, 1976).

28. Dunn and Knight, Export Finance, 14.

29. Loscher, "Export Credits: Hot Battles or Cold War", Austria Today 4 (1981): 48. The author is director of international finance at OKB (Austria's export finance institution).

30. The Official Financing of Canadian Exports, February 1983, Royal Bank of Canada. These proposals have full support of all the chartered banks and were developed under the auspices of the Canadian Bankers' Association Standing Committee on Foreign Trade.

31. See, "Report to US Congress on Export Credit Competition and the Export Import Bank of the United States", for the period 1 July 1979 to 30 June 1980, p. 57.

32. Dhawan, "Financing Canadian Exports", 662-4.

33. See EDC Circular 80-5 (revised Nov. 1981), 1, and Dunn and Knight, Export Finance, 68.

34. EDC Circular 80-5 (revised Nov. 1981), 1.

35. There is no generally-accepted definition of the terms "official export credit" or "export finance" but they are most commonly used to describe facilities provided exporters by their governments to cover risks associated with non-payment. This paper is not concerned with insurance against political or commercial risks or the provision of guarantees to private lenders, but, rather, with the provision of subsidized or unsubsidized finance by governments to exporters or to their customers.

36. For a survey of existing programs see The Export Credit Financing Systems in OECD Member Countries, (Paris: OECD, 1982) and Dunn and Knight, Export Finance.

37. For an excellent analysis of this epoch see Joan Pearce, Subsidized Export Credit, (London: The Royal Institute of International Affairs, 1980).

38. See The Erosion of America's Competitive Edge; Official Export Credits and International Competition for Jobs and Markets,

(Washington, D.C.: The Labor-Industry Coalition for International Trade, 1982).

39. Due to concerns over the legal competence of individual EEC member countries to sign such an agreement, the consensus took the form of unilateral declarations by countries that they intended to apply its guidelines. France merely implemented the guidelines without making a formal declaration; See Pearce, Subsidized Export Credit, 44-7, and Duff, "The Outlook for Official Export Credits" (1981), 13 L. and Pol. in Int'l Bus. 891, at 901-4.

40. Arrangement on Guidelines. By May 1978 all OECD members, except Iceland and Turkey (who have no official programs), had accepted the Arrangement. See Pearce, Subsidized Export Credit, 47-58 and Duff, "Outlook for Export Credits", 904-7. The text of the Arrangement is classified as confidential by the OECD and this decision is respected by member countries as well.

41. Although the Arrangement is not a formal OECD document, the participants are all members of the Group on Export Credits and Credit Guarantees, a working group of the Trade Committee of the OECD. This scenario arose because the European Court upheld the inability of EEC members to sign the consensus.

42. See Pearce, Subsidized Export Credit, 50-8.

43. See Frenkel and Fontheim, "Export Credits: An International and Domestic Legal Analysis" (1981), 13 L. and Pol. in Int'l Bus. 1069, at 1071 and Canadian Capital Goods Exports and EDC Financing: An Economic Assessment, November 1982, p. 5.

44. Arrangements on Guidelines for Officially Supported Export Credits, Interest Rate Study, Report by Mr. Wallen, OECD Doc. TD/Consensus/80.1 and Annexes (1980). See Dunn and Knight, Export Finance, 39-42.

45. Report by Mr. Wallen, p. 39.

46. L'Union d'Assureurs pour le Controle des Crédits Internationaux was founded by four European credit insurance organizations, private companies in France, Italy and Spain, and the Export

Credits Guarantee Department of the United Kingdom. After a wartime hiatus, it resumed its activities and adopted its present name in 1974. It is an association under the Swiss Civil Code, domiciled in Berne. In 1975 its secretariat moved from Paris to London. The Berne Union currently has 40 members, including Canada.

47. See Duff, "Outlook for Export Credits", 898-9. The Berne Union is alert to the fact that its members do not represent official positions. Where government action is suggested (such as when a breach of the terms of the Arrangement is alleged), participants will be directly advised and the Berne Union will not be informed.

48. "Latin American Export Bank: Agreements Establishing" (1981), 20 Int'l L.M. 934.

49. See U. Wassermann, "UNCTAD: Export Credit Guarantee Facility" (1979), 13 J. of World Trade L. 263.

50. Arrangement on Guidelines for Official Supported Export Credits.

51. Ibid., para 1.

52. Ibid., para 3. The OECD does not make public the names of countries in each category, but the names of some countries have become public; see McGovern, International Trade Regulation (Exeter, 1982), 249.

53. Arrangement on Guidelines for Official Supported Export Credits, para 2(b). Interest on export credit is not to be capitalized and is to be repayable at least every six months commencing within six months of the starting point; see para 3(b).

54. See Globe and Mail, 24 October 1983. It appears that the new agreement has not yet taken the form of an amendment to the Arrangement, but consists of a written memorandum which has not as yet been made public.

55. Arrangement on Guidelines for Official Supported Export Credits, para. 8(c).

56. Ibid., para. 99(a)(1). The United States interprets this to be

merely a "best efforts" obligation, whereas the Europeans regard it as a binding obligation.

57. Ibid., para. 9(a)(i) and (ii).

58. Ibid., para. 9(a)(3).

59. Ibid., para. 9(b).

60. Ibid., para. 10. See OECD Doc. C (81) 103 and OECD Doc. C (78) 208 and McGovern, International Trade Regulation, 250.

61. Arrangement on Guidelines for Official Supported Export Credits, para. 4.

62. Dunn and Knight, Export Finance, 47.

63. Ibid., 42-3.

64. The Japan Economic Journal, 27 October 1981.

65. Arrangement on Guidelines for Official Supported Export Credits, para. 7. In 1983 the Development Assistance Committee of the OECD adopted a set of principles for the use of aid in association with export credits. The members agreed not to provide mixed credits with a combined grant element of less than 20 per cent.

66. This is the posture of Western Germany. See The Export Credit Financing Systems in OECD Member Countries, 101.

67. Dunn and Knight, Export Finance, 48.

68. Duff, "The Outlook for Official Export Credits" (1981), 13 L. and Pol. in Int'l Bus. 891, at 940.

69. See Report of GATT, Article XVI (4) in GATT, Basic Instruments and Selected Documents, 9th supp. (1961), 185.

70. GATT, An Agreement on the Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade, B.I.S.D. 26th supp., 1979, 56.

71. This is in fact supported by the express language of the Code itself; Article 19(1) provides: "No specific action against a subsidy of another signatory can be taken except in accordance with the provisions of the General Agreement, as interpreted by this Agreement. This paragraph is not intended to preclude action under other relevant provisions of the General Agreement, where appropriate."

72. Compare with Frenkel and Fontheim, "Export Credits", 1079.
73. Customs Tariff Act, R.S.C. 1970, c. C-41, as amended, and Countervailing Duty Regulations, C.R.C. (1978), c. 520.
74. See Customs Tariff Act, s. 7(2). There are no reported cases on this section.
75. This reference is pursuant to s. 16.1 of the Anti-Dumping Act, R.S.C. 1970, c. A-15.
76. See D.R. Protheroe, Imports and Politics--Trade Decision-Making in Canada 1968-1979. (Montreal: Institute for Research on Public Policy, 1980), 162 and M. Biggs, Canada and Third World Trade--The Challenge--Adjust or Protect (North-South Institute, 1980), 82.
77. Special Import Measures Act, 2nd Sess. 32nd. Parl. 32 Eliz. II, 1983-84, c-8 (unproclaimed).
78. Ibid., s. 14.
79. Ibid., s. 31.
80. Ibid., ss. 49-54. Under these provisions, undertakings can only be accepted prior to a preliminary determination of subsidization. This appears to be aimed at avoiding the costs of an injury inquiry as well as providing an incentive for early agreement.
81. Ibid., s. 2(1).
82. Ibid., 49(1).
83. Ibid., 49(2)(c).
84. Ibid., 50(b).
85. Ibid., 52.
86. See Report on the Special Import Measures Act, House of Commons, Issue No. 31, 9 June 1982, at pp. 34-36.
87. Supra, n. 77, s. 42(3)(b).
88. Ibid., s. 2(1).
89. Ibid., s. 102.
90. Tariff Act of 1930, tit. I, ss. 101-107, added by Trade Agreements Act of 1979, Pub. L. No. 96-39, 93 Stat. 144, 19 U.S.C. 2501.
91. Trade Act of 1974, Pub. L. No. 93-618, 88 Stat. 1978, 19 U.S.C. s. 2101 et seq. and s. 2411.

92. For a summary of the US law see Frenkel and Fontheim, "Export Credits", 1080-4, and Fisher and Steinhart, "Section 301 of the Trade Act of 1974: Protection for US Exporters of Goods, Services, and Capital" (1982), 14 L. and Pol. in Int'l Bus. 569. Subsidized official export financing may violate competition as well as trade legislation. For a European example, see Commission of the EC v. French Republic; joined cased 6-11/69; Judgment of 10 December 1969; ECR XV, 538; CCH par. 8105; (1970) CMLR, 63.

93. International Trade Administration, US Department of Commerce, Final Affirmative Countervailing Duty Determination, Railcars from Canada, 48 Fed. Reg. 6569 (1983). For the preliminary determination see 47 Fed. Reg. 53760 (1982). Parallel proceedings were also commenced under the Eximbank law to authorize matching finance and under s. 301 of the Trade Act. In addition, the US registered a complaint with the GATT under Article XXII. None of these remedies were pursued subsequent to the Commerce rulings; see (1982), 13 Int'l Can. June/July.

94. 19 U.S.C.S., s. 1677(5).

95. See Frenkel and Fontheim, "Export Credits", 1080-1. For an effective criticism of this decision see Simon, "Can GATT Export Subsidy Standards Be Ignored by the United States in Imposing Countervailing Duties?" (1983), 5 NW.J. Int'l L. and Bus. 183.

96. Frenkel and Fontheim, "Export Credits", 1081-2.

97. ITA, Final Affirmative Duty Determination, 50 and Simon, "Can GATT Subsidy standards be Ignored", 200-1.

98. US countervailing duty law has also been questioned insofar as it requires proof of injury only in cases of exports from Subsidies Code members. See Hufbauer, ERb and Starr, "The GATT Codes and the Unconditional Most-Favoured Nation Principle" (1980), 12 L. and Pol. in Int'l Bus. 59.

99. Raynauld, Dufour and Racette, Government Assistance to Export Financing, A Study Prepared for the Economic Council of

Canada (1983), 22.

100. See Paterson, "The GATT and Restrictions on Foreign Investment: The United States Challenge to Canada's Foreign Investment Law" (1982), 1 U.C.L.A. Pacific Basin L.J. 224.

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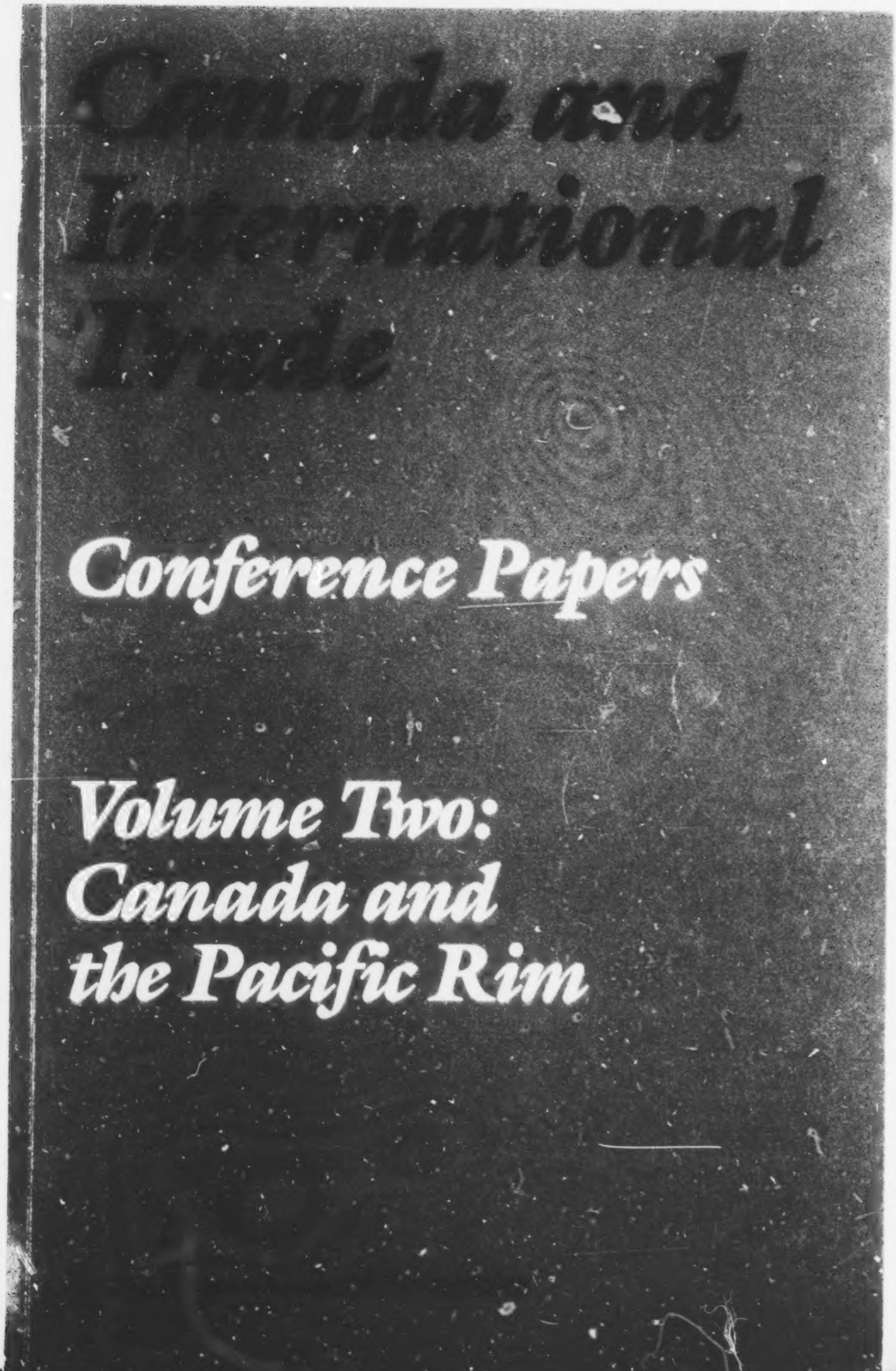

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FOREWORD

As part of the 1983 Learned Societies meetings in Vancouver, the Institute of International Relations at the University of British Columbia and the Institute for Research on Public Policy jointly sponsored an international trade conference. Timed to occur between the meetings of lawyers and economists on one hand, and political scientists and Asian studies specialists on the other, the trade conference brought together the analysis and perspectives of these several disciplines. Topics ranged from the theoretical to the empirical, and regional aspects of international trade were also discussed. The common theme throughout, however, was the public policy implications of the analysis, both in a general and in a specific sense, depending upon the paper and subject.

The conference, consisting of two plenaries, a dinner speech, and 23 papers, was divided into two sections that ran simultaneously. One section was devoted to general international trade and financial issues, the other to Canada-Pacific Rim trading relationships. The papers from both sections have been grouped by subject area in the case of the general section and by regional sub-groupings in the case of the Pacific Rim material. Most of the papers have been published in the accompanying conference volume, while the bulk of the remainder will be published by the Institute under its Essays in International Economics series once they become available. The conference papers have been published under the general editorial supervision of John Curtis of the Institute for Research on Public Policy and David Haglund, who was at the time Assistant Director of the Institute of International Relations at the University of British Columbia and is now with the Department of Political Studies at Queen's University. This essay will provide a succinct summary of the two conference plenaries, the dinner speech, and each of the papers.

Co-operation in the planning and execution of the conference between the two Institutes--one university-based and the other independent--was exemplary. This fact, combined with cross-disciplinary interaction that took place, made the experience most worthwhile for all concerned.

Gordon Robertson

AVANT-PROPOS

Dans le cadre des réunions des Sociétés savantes qui eurent lieu à Vancouver en 1983, l'Institut des Relations internationales de l'université de la Colombie-Britannique et l'Institut de Recherches politiques parrainèrent conjointement une conférence internationale sur le commerce. Insérée entre des réunions de juristes et d'économistes d'une part, et celles des politicologues et spécialistes ès études asiatiques d'autre part, cette conférence allait réunir en un même forum les perspectives et les analyses propres aux quatre disciplines. Les sujets abordés allèrent du théorique à l'empirique, et la discussion porta également sur les aspects régionaux des échanges internationaux. Mais le thème commun autour duquel devaient s'articuler les travaux de la conférence fut l'incidence de l'analyse, tant sur le plan général que particulier, et selon le sujet et la présentation, sur les politiques officielles.

La conférence, qui comprenait deux plénières, un banquet-causerie et 23 exposés, fut scindée en deux salles qui siégèrent simultanément. La première fut consacrée au commerce international et aux questions financières en général, et la seconde aux relations commerciales des pays du bassin du Pacifique. Les textes des exposés présentés dans les deux salles ont été regroupés par domaines dans le cas de l'atelier 'général' et par sous-groupes régionaux dans celui du bassin du Pacifique. La majorité des exposés ont été publiés dans le recueil des actes de la conférence; quant aux autres, ils seront pour la plupart publiés par l'Institut dans sa série 'Essais sur l'économie internationale' dès qu'ils seront disponibles. Les actes de la conférence furent publiés sous la direction générale de John Curtis, pour l'Institut de Recherches politiques, et de David Haglund, qui était à l'époque directeur adjoint de l'Institut des Relations internationales de l'université de la Colombie-Britannique et qui travaille actuellement pour le département d'Etudes politiques de l'université Queen's. Le présent essai constituera une brève synthèse des deux séances plénières de la conférence, ainsi que du banquet-causerie et des exposés.

La planification et l'organisation de la conférence furent un remarquable exemple de coopération entre les deux instituts dont l'un a une vocation universitaire et l'autre est totalement indépendant. Et cette collaboration, alliée à l'interaction pluridisciplinaire à laquelle elle donna lieu, produisit une expérience des plus précieuses pour tous ceux qui devaient y prendre part.

Gordon Robertson

SUMMARY

CANADA AND INTERNATIONAL TRADE: A CONFERENCE SUMMARY

John M. Curtis
and
David Haglund
and
Roman Lepiesza

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CANADA AND INTERNATIONAL TRADE: A CONFERENCE SUMMARY

Panel 1: The Western Provinces and Canadian Trade Policy

A general view that the West would have to define more clearly its interests with respect to international trade, and that the federal government would have to show increased sensitivity to western Canadian interests emerged from the opening plenary session. Panelists as well as commentators from the floor focussed in particular on the need for Canada to advocate open world markets into which products of the western provinces could be sold. All agreed that this position was not always clearly and consistently advocated, and that the processes of federal-provincial co-ordination were not perfect, both of which detracted from this objective.

This latter point received particular emphasis from Ed Shaske, who was speaking on behalf of the Government of Alberta. He noted that contemporary western Canadian involvement in Canadian trade policy development dated from the Western Economic Opportunities Conference (WEOC) held during the summer of 1973. International trade had been identified as a priority item for the West at that time and had remained so.

With the creation of the Canadian Trade and Tariffs Committee in 1975 and the inclusion of the provinces on that committee, the West was able to actively promote the case of freer trade. Briefs on agricultural and industrial trade liberalization were prepared in late

1976 and early 1977, and a further comprehensive brief was presented by the Government of British Columbia late in 1977. As well, conferences of western premiers at Brandon in 1977 and at Yorkton in 1978 had taken freer trade positions. At the official level, 1978 was characterized first by a response to the non-tariff barrier (NTB) draft codes and later by the draft subsidy and countervail codes. Finally, in 1979 a provincial liaison committee concerned with trade and the GATT was established. It was followed by a provincial government recommendation that the federal-provincial mechanisms developed during the Tokyo Round be maintained, a proposal that Shaske still supported.

Current issues of trade policy involving both the western provinces and the federal government were highlighted in the panel discussion by Barbara Johnson, who represented the Government of British Columbia. She noted that the Special Import Measures Act before the federal Parliament in the 32nd Session had been the subject of federal-provincial discussion since July 1980. Her concerns and those of her government were related to the lack of transparency in the institutions and processes involved, the fast-trade characteristic of the proposed system for imports, and the apparant lack of concern for both consumer and regional interests. In sum, the proposed Bill appeared to reflect traditional eastern concerns more than western or Atlantic ones.

Johnson was more optimistic with respect to two other current issues: the lumber countervail and the Japanese auto import situation. While federal action with respect to the first had been perhaps somewhat slow and with respect to the second clearly contrary to certain western Canadian interests, the degree of co-operation between the two levels of government even on these issues was quite strong. While co-operation overall might be less formal than had been the case over the past ten years, Johnson added, the parallel interests of the two levels of government in export promotion would ensure ongoing co-ordination.

The third panelist, Professor Ronald Shearer of UBC, emphasized his worry about the weakening of the traditional British Columbia policy thrust of liberalization. While any political jurisdiction pursues basically the same policy of getting as high a price as possible for its exports and paying as low a price as possible for its imports--especially if the competing good can be produced locally--Shearer suggested that British Columbia should be more consistently outward-looking. He even found, from time-to-time, restrictions on goods that the province could not produce.

As for the overall effectiveness of the British Columbia's, and more generally the western provinces', role in national trade policy, Shearer felt that several factors were in play. The current recession was occasionally leading to poor policy decisions, the constitutional division of power did not encourage a national perspective with respect to policy-making, and age-old grievances concerning the cost of the tariff, for example, which had been so well examined in the Rowell-Sirois report, had not been solved.

Panel 2: Canada and the Future of Multilateralism

The second plenary, coming at the end of the conference on the second day, had as its focus the future of multilateralism. Robert Joyce, the Executive Director for Canada at the International Monetary Fund, outlined what he thought was the overall perspective of the Fund at the moment. Perhaps, most important was the growing appreciation of the reality and consequences of economic interdependence. The current international debt crisis involving so many countries, both North and South, made this clear. Also of importance, Joyce added, was the increasing recognition that the state of micro-economic structures and policies determined to a large extent the success of macro-economic performance. Regulatory and labour market systems, for example, had an impact on inflation. In its deliberations and analyses, the Fund was concerning itself increasingly with micro-economic variables.

Third, the perception that change means adjustment was growing stronger. The world economy had clearly undergone major shifts in the 1970s and early 1980s. Those economies that had performed best during that period, and whose outlook was relatively strong now, had demonstrated a particular flexibility in the face of change. Such changes, whether due to technological or other internal or external factors, were a fact of life. They were not a passing phenomenon in the view of the Fund; each country would have to adjust if it wished to profit fully from being a partner in the world economy.

Joyce then drew several conclusions with respect to the world's trade and financial system in the context of the above perceptions. One was the likelihood that international surveillance would increase. Such surveillance would comprise not only exchange rates, already allowed for under Article 4 of the revised Bretton Woods articles, but also interest rates, as well as trade and investment problems. If things developed along these lines, Joyce added, further initiatives would be required to bring finance and trade ministers together. The many historical reasons for separating the two functions, whether for bureaucratic, institutional, or intellectual reasons, were no longer valid or appropriate in today's world. A US initiative to have finance and trade ministers meet had been taken in May 1983 following the OECD Ministerial meeting and more such initiatives were to be expected.

A further implication of the several recent trends referred to by Joyce was the likelihood that eventually there would be better explanations as to why exchange rates floated in certain ways and under what conditions. In addition, improved analysis would soon be available concerning the trade implications of each possible exchange-rate configuration. It was by now well recognized that the operation of the exchange rate was highly relevant to trade policy.

Also of importance in this context was the ability of the trade and finance system to cope with the financing of LDC debts. The opportunity to trade was one important component in enabling the heavily indebted countries to work down their liabilities. Economic growth as well as effective and acceptable adjustment policies in the industrial economies were crucial elements in this trade-related aspect of the global debt crisis. It was yet another reason why finance and trade ministers would have to work even more closely together in the future.

A final point raised by Joyce during his presentation at the plenary was the question of the appropriate multilateral forum for trade and finance discussions. The Fund was one such appropriate place, as trade issues had been continually discussed there for years in connection with the macro-economic performance reviews of member countries, and the GATT was another. Given the stated agenda concerning many items in front of the GATT presently, Joyce thought that adding the international finance component to trade policy analysis already underway at the GATT might be particularly important.

Bill Jenkins, Assistant Under-Secretary of State for External Affairs, stressed in his plenary session the alternative ways that the international trade system could be made to work on an ongoing basis. While his participation at the GATT Ministerial meetings the previous November (1982) had made him more pessimistic than before, he nevertheless remained confident that international co-operation in the trade area would continue.

One method to ensure this co-operation continued would be moral suasion. International agreements would not be binding and their effectiveness would therefore vary. The UNCTAD and the United Nations itself operated on this principle, Jenkins reminded his audience, and so did sections of the GATT and of the IMF.

Another related principle of international economic co-operation was the formation and maintenance of clubs. Participation in the clubs was of course voluntary. Once a country became a member, however, certain obligations had to be accepted, even if they infringed on national sovereignty.

Last, according to Jenkins, were the binding contracts that had characterized the early part of the post-1945 era. While highly desirable, such arrangements were increasingly difficult to negotiate in multilateral fora. Different circumstances and needs made such agreements even less likely in the future.

In one area--that of compensation and retaliatory action in connection with actions taken by trading partners--Jenkins expressed serious concern. This was based not only on the pressure at present to protect, but also on the unilateral actions and counteractions taken and the serious potential for their escalation.

Professor Ted English of Carleton University stressed throughout his presentation a point that he had made many times before: that there was a basic complementarity between multilateralism, regionalism, and even bilateralism. One system need not exclude another; indeed dynamic analysis suggested that sub-global groupings had certain cumulative benefits for the world economic system as a whole. He reminded the audience that the Pacific Rim, for a number of reasons well stated elsewhere, was one such area.

Sidney Weintraub, Dean Rusk Professor of Public Affairs at the University of Texas, stressed the point that all countries seek maximum room for independent action. Yet they all wish to achieve their objectives in the most effective way possible, which at times has meant joining international organizations. In so doing, they accept some limits on national power. In the present context, Weintraub suggested, such willingness to accept international obligations could be used to slow down protectionism. Given present circumstances, however, he could not foresee any scenario by which, for example, a safeguards code acceptable to all could be negotiated. As well, he was nervous about reciprocity talk in the United States. He remained hopeful that Canada-United States preferences consistent with both countries' multilateral obligations could be worked out, although how this initiative might fit into current Washington thinking was a very open question.

John Curtis, the director of the International Economics Program at the Institute for Research on Public Policy was the final speaker. He addressed what he called the new multilateralism. This new system, he envisaged, would evolve from the existing system, encompassing more countries, covering more national policies, and strengthening existing rules and procedures. Like the existing system, it would still ensure that order, predictability, fairness, and freedom characterized international economic relations.

As part of the renewed system, it would be desirable if the maintenance of a healthy trading system became an explicit objective of individual countries' economic policies, not unlike the low inflation, high employment objectives that currently characterized national economic policies. Further, industrial and structural policies, now considered to be entirely domestic, should be made subject to international rules and to supervision by an international authority. Improved procedures for complaints and more continuous discussions, especially at the political level, would also be part of the proposed new multilateral system.

Curtis also stressed the importance of investment performance requirements as part of a rejuvenated system, as well as internationally-accepted norms with respect to the trade in services. He also pointed out that while smaller countries such as Canada had a role in making the system work, one could not diminish the responsibilities that larger countries had. It was often the practices of these large countries that smaller countries emulated.

The brief discussion that followed centred largely on questions of the political environment. One intervention stressed the importance of the market rather than government instruments in helping to solve trade problems. The free trade zones evolving in the United States and Europe provided an example. Another interlocutor cautioned against any grand plans to restore the international trade system--even in the favourable circumstances of 1948, there had been a limit to what could be achieved. Yet another comment from the floor noted the importance of what was termed a "coherent pluralism" in international trading arrangements. As long as various organizational set-ups were consistent with broader, established principles, they should be encouraged.

Dinner Speech: Prospects for the World Economy

The speech given by Robert Johnstone, the federal Deputy Minister of International Trade and Co-ordinator of International Economic Relations, stressed both the interconnected nature of the world's current economic problems as well as the view that the existing international economic system needed strengthening rather than overhauling. Johnstone stated that nations for too long had tended to turn inward and that a new commitment to international economic co-operation was needed. In his view, far-sighted and courageous political leadership--as well as far-sighted and imaginative business leadership--were critical at the present time.

Johnstone argued that current macro-economic (including interest-rate) policies, payments imbalances, debt problems, trade-protectionist pressures, and the plight of the very poor countries, reflected in various interconnected ways the inheritance of a fairly long period of mounting disorder in national economies around the world, and in the workings of the world economy as a whole. In order for one to be optimistic about the future, Johnstone suggested that some progress with respect to all five of these problems would have to occur. With respect to macro-economic policies, for example, one would have to be concerned about the prospects for nominal and real rates of interest in the United States. High US and other interest rates could well abort the recovery. But, Johnstone continued, no one outside the United States could or should lecture the Americans on reducing their budget deficit without attacking President Reagan's policies on defence and taxes. Yet such a reduction was essential to permit a reduction in rates. Moreover, authorities in other important countries, especially West Germany and Japan, were loath to adopt stimulative measures, for a variety of reasons.

In Johnstone's view, major payments imbalances were driven by inappropriate exchange-rate relationships, and could only be ameliorated if more convergent economic policies and performance were in place across the OECD countries. Tinkering with exchange rates would not bring about the desirable longer-term equilibrium in the balance-of-payments position of a country.

The third interconnected element of disorder to be overcome, Johnstone continued, is the debt problem of several major developing countries. He argued that success on the first two fronts--those of the macro-economic and balance of payments--would greatly ease the pressures of financing the deficits of LDCs. Nonetheless, he added, these countries must go through very severe periods of adjustment if they are to regain the all-important confidence of the financial community. Management of the debt problem would also require fully adequate resources in the IMF and a further development of the collaboration that has developed among banks and between the banks and the IMF.

Turning to his fourth point, Johnstone commented that trade policy issues, particularly pressures for protectionism, would be tough enough to handle, even on the most sanguine assumptions about growth, exchange rates, and debt. He added that pressures on the trade system had resulted not just from recession but from problems associated with adjustment to change. This change resulted both from the development of new centres of productive power in the world and the related need for adjustment in major sectors of the industrial economies.

Johnstone noted in this connection that on the trading front, as on so many other fronts, the world is a more complicated place than it was in that period after World War Two when the institutional framework of the world economic system was built. During the late 1940s and 1950s, the players were few in number and they shared a common view of what was needed. For many years thereafter, he said, there was a happy parallelism of perceived national interests and the building of an open world system. Now, however, there were more players sharing to a much lesser extent a common view of what was needed. It was much harder to find that happy parallel between perceived national interests and the requirements of an open and disciplined system at a time of widely differing circumstances, in a time of disorder and uncertainty.

Finally, Johnstone reminded the conference of the world's forgotten people, the poorest of the poor. They were forgotten in his judgment because in our concern about low growth, high debt and other issues we have tended to overlook the needs of these peoples and countries. But these people could not be forgotten, he argued; for quite apart from a fundamental humanitarian concern, there were vexing issues of political and social stability, as well as of security, at stake.

To solve the problems of the poor, to alleviate unemployment particularly amongst the young, to ensure our collective capacity to deal with debt problems as they arise, and to lessen pressures for trade restrictions will require good policies, good luck and a good deal of international co-operation, Johnstone concluded. Canada, he added, must remain a full-time player.

The Papers

Canada and International Trade

The conference papers concerned with general trade questions focussed on rapidly changing and increasingly complex international economic and policy environments.

The first set of papers, by Ted Cohn, Lenard Cohen and Paul Marantz dealt with the political aspects of Canadian trade policy. Cohen and Marantz examined Canadian-Soviet trade relations by focussing on conditions in the Soviet Union.[1] The authors did not forecast major changes in Canadian-Soviet trade, although they argued that the Soviet Union is interested in diversifying its trade and expanding its exports.

In his paper on Canadian and Mexican trade policy towards the United States,[2] Cohn addressed directly the growth of new forms of protectionism in the United States and the increasingly active and vocal role the Congress is playing in US trade policy. The focus of the paper was on the mutual lessons Canada and Mexico might learn from dealing with the United States. Cohn dealt with the specific concerns in resolving disputes with, and obtaining special treatment from, the United States. He pointed out that both Canada and Mexico share many common problems in dealing with the United States. Given the importance of the US market, the formation and implementation of US trade policy will continue to play a major role in the trade prospects of Canada and Mexico.

The question of Canada-United States relations, both bilaterally and multilaterally, was further examined in papers by David Cohen and Chris Thomas on the legal aspects of Canadian-US trade. The two papers focus on two sets of issues that have occupied an important place on the agenda of Canada-United States trade relations, especially over the past decade. One set of issues arises from the lack of international rules in the area of competition policy, and the efforts by US courts and government agencies to assert US antitrust jurisdiction over economic activities in other countries. The other set of issues surrounds the growing body of regulations in most countries, including Canada and the United States, governing product standards and consumer protection; the effects of these regulations and product standards on international trade; and efforts within GATT to establish international rules aimed at minimizing barriers arising from these regulations and standards.

Thomas' paper[3] pointed out that while Canadian and US approaches to competition policy were generally similar, there did not exist a more broadly based international consensus on the role of competition in economic affairs. The main focus of the paper, however, was on a series of antitrust determinations by US courts and on policies followed by US antitrust enforcement agencies, which represented efforts to assert US jurisdiction over anticompetitive activities in other countries, even where these activities conformed entirely to the laws of other countries and might even be mandated by their governments. Such extraterritorial assertion of US jurisdiction (which is paralleled by the extraterritorial assertion of US jurisdiction in other areas) had given rise to much friction in Canada-United States relations. In recent years, Canada as well as other countries had adopted or were in the process of adopting retaliatory responses of various kinds. But a lasting solution to problems in this area called for a rationalization of the role of antitrust enforcement in the United States, the development of a broader international consensus on the role of competition in economic affairs and, most important, because it remains the most significant problem, the development of rules of international law concerning the jurisdictional reach of states in an increasingly interdependent world.

David Cohen's study[4] made an important contribution to understanding a particularly complex set of international issues relevant to Canada's trade and other interests. It has been widely recognized that consumer protection regulations and the establishment of product standards can have a large impact on international trade, as these serve as deliberate or incidental barriers to imported products, distorting the flow of trade, and increasing manufacturers' costs. During the Tokyo Round of trade negotiations in the 1970s, a "Standards Code", adopted within the GATT framework by Canada and a group of other countries, aimed to reduce trade barriers arising from the existence of differing or conflicting product standards and the development of internationally accepted standards. One of the main conclusions of Cohen's paper was that a set of common "North American standards" has emerged, largely as a result of the use in Canada of standards written in the United States. One result is that standards requirements and regulations present only minor non-tariff barriers to the flow of bilateral trade. The paper points out, however, that the adoption by other countries of US standards serves to reinforce the expansion of American exports in foreign markets. Furthermore, it suggests that the United States will use the GATT Standards Code, as well as international standard setting bodies such as the International Standards Organization, to export its standards beyond the North American continent. Canada, Cohen suggested, should ensure that Canadian trade interests, and also the interests of Canadian consumers and labour, are protected in the process of establishing international product standards. Another important conclusion of the paper was that because of stricter consumer product liability laws in the United States, Canadian manufacturers face considerably greater risks in exporting to the United States than do American firms in exporting to Canada. The paper also suggests that Canada's bilingual labelling regulations do not represent a significant barrier to imports, nor do they impose any substantial additional costs on imported goods.

The interaction between trade policy and domestic industrial policy was taken up by Professors Don Paterson and Ron Shearer.[5] The authors provided an historical analysis of the role and impact of Canadian trade policy on the industrial structure of Canada from Confederation to the present time. Drawing upon their own empirical work as well as upon studies by others, Paterson and Shearer concluded that Canadian trade policies have been largely ineffective in changing the pattern of trade or the industrial structure in the ways intended; these policies continue to impose economic welfare losses on Canadians.

The authors concluded that Canada should not be the vanguard of the international forces of protectionism. Quite the contrary was true, given Canada's relatively small size and factor and product endowments. The essentially mercantilist concept of national interest in Canada--as demonstrated by bilateral or commodity-specific trade balances, the proportion of exports that are "hight tech", and the proportion of the labour price employed in high quality jobs--was seen as an inappropriate framework for Canadian trade policy.

The papers under the general heading of Canadian Commodity Trade focussed on a study prepared by Michael Webb and Mark Zacher[6] and a study by David Haglund.[7] Both papers attempt to extend research into complex areas of special interest to Canada at a time when there are significant changes in patterns of world mineral production and trade.

Over the post-war period, international agreements to stabilize world markets had been concluded within the United Nations framework for a number of primary products, but not for any of the minerals produced or exported by Canada. As the paper by Webb and Zacher pointed out, most of the negotiations for such agreements since the 1960s had been set in the context of North-South confrontations; and Canada did not fit comfortably into either the group of industrialized importing countries or the group of developing country exporters. Their paper examined separately and in detail the post-1945 record of Canadian government policy towards the adoption of agreements covering six minerals exported by Canada: copper, iron ore, lead and zinc, nickel and uranium. It concludes that Canada has generally been opposed to formal intergovernmental commodity agreements for these products; that Canada has generally rejected participation in cartels among producer countries, but that the government has supported efforts of private industry to manage and stabilize minerals markets. One of the factors that has influenced government policies was that "producer price systems" have prevailed, at least until recently, in Canada's main export markets for minerals products, notably the United States, providing Canadian exporters with somewhat higher and more stable prices than those prevailing in other export markets that lacked effective management by private producers. Another factor has been the opposition to formal intergovernmental commodity agreements by private Canadian producers of all the minerals concerned, with the exception of uranium. Canadian producers, however, have co-operated in informal international arrangements for information sharing and consultations among producing and consuming countries.

Other factors influencing government policies, Webb and Zacher concluded, have included difficulties of co-ordinating federal and provincial interests involved, opposition to such agreements by other industrialized countries, especially the United States, and doubts about economic benefits for Canadian private producers. The paper calls for a closer dialogue in the future between Canada and less-developed exporting countries on possible collaborative market strategies.

David Haglund's paper examined the concerns major industrialized countries have expressed over the past decade about the security of their raw-material supplies, especially of so-called "strategic minerals" such as oil from the Persian Gulf, and a range of metals: cobalt, chromium, manganese, the platinum group metals, and vanadium, the production of which is concentrated in southern Africa. The study finds that recent Western concern for mineral security is not likely, at present, to translate into major direct gains for Canada as a minerals exporter. Canadian production of cobalt and the platinum group metals cannot be appreciably increased unless production of nickel and copper is expanded, and Canada has no production of chromium, manganese or vanadium. Chromium production could conceivably get under way in Canada in the 1980s, but would require subsidization either by Ottawa or by Washington. Washington, Haglund stated, is more likely to subsidize the development of chromium resources in the United States.

Rodney Grey, former Canadian ambassador to the GATT, extended the discussion on trade rules by addressing the question of the appropriateness of the GATT as an instrument for dealing with trade in services.[8] As a new but rapidly growing area in trade, service trade does not fall under the explicit regulation of the GATT. Grey examined the major principles and rules of the GATT with respect to their possible applicability to dealing with the major horizontal policy issues in trade in services. He concluded that it would be inappropriate at this time to attempt to integrate trade in services into the current GATT structure. He further concluded that the top priority for the GATT was to strengthen the existing rules and to address the outstanding issues such as safeguards in the area of industrial goods trade.

The interdependence between trade issues and international monetary issues was the theme of the last session on general trade issues. Debra Glassman examined the impact of Canadian dollar futures trading on the Canadian exchange rate, focussing on the policy implications for managing the Canadian dollar.[9] She noted that generalized floating of exchange rates from the early 1970s onward had brought two major surprises. One was that floating exchange rates did not provide the complete insulation of the domestic economy from external influences that theoretical writings of the 1950s and later had suggested. Secondly, exchange rates under a floating regime fluctuated far more than most analysts expected.

Because there was now enough data available to begin to evaluate the floating rate experience, Glassman was able to begin answering the question of whether the exchange rate volatility observed could be blamed on destabilizing speculation. She found, on the basis both of her own work and that of others, that the evidence on foreign-exchange market efficiency is not conclusive. The sensitivity of the results to different kinds of tests, different estimating procedures, and different choices of test statistics was disturbing. Further, there was some evidence that inefficiency was associated with certain time periods when foreign exchange markets are active or volatile. As well, she found that inefficiency may be a short-term phenomenon, lasting only a few days or weeks.

Glassman concluded that whether or not there had been excessive exchange rate volatility and/or destabilizing speculation under managed floating remained an open question. The extent of central bank intervention and frequently voiced concerns about the degree of volatility indicate, she concluded, that public officials at least are not happy with the fluctuations. Many corporate treasurers had been kept busy devising strategies to hedge exchange risk and reduce foreign exchange exposure. This had become a big business, and a costly one. The resources expended in these activities would be free for other purposes if exchange rates were more stable and hence more predictable.

Bob Paterson and Michael Hicks[10] addressed under the same heading the issue of export financing and in particular the problem and policy alternatives facing Canada in this critical area of commercial policy. They reviewed the history of official export finance, including an evaluation of the Canadian Export Development Corporation, and noted that the international regulatory regimes--the Berne Union of 1934, the Article XVI provisions of the GATT, and the 1978 OECD Agreement on Guidelines--were all very underdeveloped. Since the international legal status of such regimes was very weak, export subsidies generally were not subject to countervailing duties. Private complaints about foreign export credits in breach of domestic law were subject, however, to a structured and formalized system in the United States, as evidenced in the Bombardier case, and to a much less formal system in Canada.

Overall, Paterson and Hicks found that no cases of government involvement in export financing were identical. Because all major exporters were competing for identical markets, it was not surprising that a degree of uniformity in practices had emerged. Still, the authors concluded, there remained major problems related to official export financing, none of which is susceptible to a simple solution. In the Canadian case, the EDC faces many domestic pressures to match the terms of foreign agencies, pressures which are exacerbated by the complex international legal aspects of the export credits problem.

John Curtis discussed Canada's involvement and positions on international monetary issues.[11] He noted that little of what has been written in recent years about the international financial system in general, and the International Monetary Fund (IMF) in particular, has had a Canadian focus. This fact was all the more surprising, he thought, given the long and continuous Canadian involvement in the system since its founding in 1944, and given the Canadian public's almost daily fixation with the Canada-United States exchange rate. Further, the Canadian debate on international financial policy and institutions has been essentially a private one, a situation unlikely to change until information and analysis done by the very few agencies involved become more widely available.

Curtis added that since the collapse of the Bretton Woods fixed exchange rate system, the level of the exchange rate had become a major international trade issue. From the limited amount of publicly available material, he found that over the years the Bank of Canada had always vehemently opposed any deliberate devaluation of the Canadian dollar. The Canadian government's position, in contrast had been more ambiguous.

Canada and the Pacific Rim

The conference papers concerned with Canada-Pacific Rim trading relationships focussed on recent economic developments in the diverse, dynamic region of the West Pacific littoral, often referred to as the Asia-Pacific Basin. Developments such as the emergence of China, and more than 15 years of rapid economic and trade growth of several Pacific Basin countries provided a most illuminating backdrop to an active discussion of the mounting economic opportunities and challenges facing Canada in its relationships with Asia-Pacific countries in the 1980s. A total of 12 papers were presented in six separate sessions: two on Japan, two on China, three on Southeast Asia, and one each on the newly industrializing countries of East Asia, joint ventures, fisheries arrangements, organizational ties, and economic change in the Asia-Pacific region.

Professor Frank Langdon addressed the issue of Canada and the internationalization of the Japanese economy.[12] The Japanese concept of "internationalization" has been given strong support by Nakasone's government, and implies mostly the liberalizing of the Japanese economy, combined with an emphasis on more Japanese investment abroad. In spite of the publicity surrounding these changes, Langdon suggests that, due to the inherent competitiveness of Japanese production, the impact of liberalization on Japan's trade with the West will be marginal.

With respect to Canadian trade with Japan, Langdon points out that Japanese liberalization efforts have resulted in virtually no change. Though tariff-related difficulties remained, it is the demanding nature of the Japanese market which is particularly problematic for Canada. Thus, though new opportunities have been opened up in the service sector of Japan, Canada's potential is limited by competition from third parties. Consequently, Canadian trade remains dependent on large exports of natural resources. Even in this sector, however, Canada's position is threatened, not only by changes in demand resulting from the economic restructuring being undertaken by the Japanese but also by competition from other suppliers. Moreover, Japanese investment in Canada remains relatively small, and any sharp increases would likely occur in the energy sector.

In summary, Langdon concludes that, though Japanese "internationalization" opens new opportunities for Canada, these are small and will require strong Canadian efforts to be fulfilled.

A somewhat different perspective on Japan's internationalization process was presented by Malcolm Smith. Focussing on the legal and administrative changes which have occurred in Japan over the past five years, Smith sought to identify the type of legal model employed in Japan, so as to further understand the fundamental operations of Japan's economic system and particularly the mechanism of the internationalization process.[13] Two opposing systems within the legal framework were discussed; the legalistic framework with its well-established set of rules (laws regulating foreign investment and foreign exchange transactions as well as domestic laws which have an impact on trade) and the discretionary framework, consisting of certain practices whereby intervention occurs at the institution's discretion. In contrast to the rigid legalistic framework, the discrectionary framework is characterized by speed and ease of use.

After citing similarities in the broad, vague wording of legislation in both Japan and Canada, wording which he claims leaves the door open for intervention, Smith concluded that over the past few years, Japan's legal framework has been shifting from the discretionary to the legalistic, thus shifting in the direction of trade liberalization. However, Smith warns that recent trade friction between Japan and its major trading partners is pushing the Japanese administration back to the point of using discretionary practices rather than moving it forward to a more transparent legalistic framework.

With respect to format, the China session broadly paralleled that of Japan. The first paper dealt with trade-policy issues while the second focussed on the emergence of contract law in the People's Republic of China. Samuel Ho and Ralph Huenemann, co-authors of the trade paper, outlined developments in China's "open door policy", a policy which has been designed to attract much needed foreign technology to shore up major gaps in China's manufacturing industry and infrastructure.[14] China's open door policy therefore marks an historical turning point in that China now welcomes long-term investment; in order to attract foreign technology and investment, a wide variety of special trade instruments are now being used, including equity joint-venture, compensation trade and processing and licencing arrangements.

Ho and Huenemann note that before China's open door policy becomes a viable alternative to the country's long-standing policy of self-sufficiency, China's economy must undergo a period of adjustment during which two major issues must be resolved. The first issue concerns an ideological debate over the appropriateness of pursuing sectorally-balanced versus unbalanced growth as a vehicle for domestic economic development. Balanced growth favours the sectors of agriculture and labour-intensive manufacturing while unbalanced economic development would necessitate extensive investment in heavy, capital-intensive industries. The second issue centres around the need for reforms in China's resource-allocation mechanism so as to better absorb and pay for foreign technology. The authors outline a number of structural economic and institutional constraints which hamper China's overall modernization process in general, and the open door policy in particular, and conclude that the real test of whether China will attract, assimilate and absorb a significant amount of technology and capital is about to begin.

Just as the open door policy marked an historical turning point in China's economic evolution, so did China's policy decision to establish a body of contract law set new precedents. It is historical in that communist China is, for the first time according to Robin M. Elliot, attempting to guarantee equity through the legal system.[15] China is seeking therefore to establish a system of government that is based far more than it ever had been on the rule of law. The introduction of contract law in China reflects a changing economic system, in which decentralized elements have responsibility for putting broad plans into effect.

Within this context, Elliot notes that the Economic Contract Law plays a number of different roles. It provides a framework of rules for the conduct of business activities involving products and items not covered by long- and short-term economic plans. It ensures that those plans will be put into effect, by enforcing that contracts be consistent with the targets set by the mandatory plans. It also makes clear that enterprises that do not live up to their contractual obligations will be liable to penalty payments and damages to be paid out of profits. It encourages, therefore, greater operating efficiency and care. Elliot cautions, however, that one should not assume that all economic dealings in China are now being conducted in strict accordance with the provisions of the Economic Contract Law. In fact, the implementation process has been, and will continue to be, a gradual one, with the large enterprises in the major centres being the first to be brought within its scope and the smaller enterprises in the smaller centres likely to be the last. Throughout the paper, Elliot looks at contract law under its various articles: formation of contract law, variation and cancellation, liability for breach, dispute resolution, and management of economic contracts, all areas of interest to the foreign investor.

In a session entitled "Canada and the Pacific Rim: East Asian NICs", Roy Matthews examined Canada's trade relationships with the newly-industrializing countries (NICs) of East Asia, South Korea, Hong Kong and Taiwan. His presentation was a capsule summary of a larger study published by the Institute for Research on Public Policy earlier in 1983.[16] According to Matthews, the economic story of the three East Asian states is actually a replay of the Japanese experience, but at a much lower level of industrial sophistication and narrower scope of trade diversification, at least for the present. Central to the discussion is an outline of the mounting opportunities and challenges surfacing in the East Pacific region. Matthews envisages an increase in trade in a market that is not enormous but one that has been rapidly growing and has inherent potential to run ahead of most other countries. Matthews expects a wave of competition from East Asia's NICs as they move up-market, producing higher value-added export goods. But unlike past competition, which affected Quebec's clothing industry, this next competitive wave will hit Ontario. The so-called "New Japans" will present Canada with mounting challenges. Matthews' underlying theme is that there will be the need to refrain from protectionist tendencies and face necessary economic adjustment.

Three papers dealt with Canada-Southeast Asia economic relations. One paper centred on Canada-Indonesia economic relations, the two others on a group of countries joined in a quasi-economic organization, the Association of Southeast Asian Nations (ASEAN), whose members are Indonesia, Singapore, Thailand, Malaysia and the Philippines. In his paper on Canada-ASEAN economic relations, Donald Crone noted that the focus of Canadian policy in Southeast Asia has shifted both in nature and interest, from one based narrowly on Commonwealth and regional security concerns to one based on economic considerations. This has led to a broadening and deepening of ties with the region.[17] Canada's trade and aid relationship with ASEAN has risen and there are attempts to build a wider relationship with ASEAN through various co-operation programs; it is hoped that such developments will eventually transform the nature of the existing relationship, which is based largely on aid, to one based more on trade.

In Crone's view, ASEAN is attempting to diversify its economic base and relationships with other countries so as to lessen the influence of its major trading partners, the United States and Japan and, to some extent, to lessen the influence of the bigger powers of Europe, notably the recent colonial masters. According to Crone, the base for future Canada-ASEAN relations is a common search for a third option strategy. This base is reinforced by a degree of complementarity between Canada and ASEAN with respect to levels of economic development and the potential mutual benefits of economic co-operation.

On the topic of Canada-ASEAN economic relationships, Keith Hay and Donald Lecraw outlined in their study the economic successes of, as well as the prospects and opportunities for, the five ASEAN countries.[18] Hay indicated that for almost two decades the economic structure of ASEAN has undergone a transformation. Agriculture as a proportion of total output in the various ASEAN countries has been steadily falling, while secondary industry and labour-intensive and service industries have been rising in significance. Approximately one quarter of total exports now stem from the output of the manufacturing sector, a significant feat considering that not long ago ASEAN trade was almost completely dominated by raw resource products. According to Hay and Lecraw, economic growth and the transformation process in ASEAN has been constrained by balance-of-payments problems in recent years, a condition that is determined by external factors beyond their control. Although the Canada-ASEAN relationship will be influenced by these conditions, prospects for Canada will remain reasonably bright owing to a relatively strong demand in ASEAN for the goods and services required to develop substantial resource endowment, infrastructure systems and a broad manufacturing base. The challenge for Canada is to find ways to penetrate the ASEAN market while at the same time opening up to the labour-intensive products from ASEAN countries, a process which will involve domestic economic adjustment.

Geoffrey Hainsworth examined the main components and trends in Canada-Indonesia economic relations over the past 15 years or so and sought to discern the potential for more mutually beneficial relations in the years ahead.[19] Since it is a major "country of concentration" for Canadian bilateral aid, there has been substantial subsidization of Canadian exports, consultancy and investment in Indonesia. Canadian firms have not fared well in competition with other suppliers in bidding (for example, for World Bank and Asian Development Bank contracts), and Canadian polices to stimulate self-sustaining exports and joint ventures under the Program for Export Market Development and CIDA's Industrial Cooperation programs have been disappointing. This has led many observers, notes Hainsworth, to question whether Canadian firms, other than half a dozen multinationals, have the skill and fortitude to extend their operations or even hold their own in what is likely to become an increasingly complex and demanding arena.

In seeking a more positive assessment, Hainsworth attempts to identify within Indonesia's development priorities those sectors in which Canadian expertise and comparative advantage are most likely to be secure and to assess how far such "beach-heads" might provide entry for more extensive Canadian participation. Indonesia has a strong propensity toward linkage and packaging when it comes to negotiating components of its foreign economic relations, as in the recent "counter-purchase" requirements in government procurement contracts. Canada's current reorganization of its External Affairs department appears to offer a counterpart negotiating strategy. This bilateral approach may also give Canadian firms more preferential access to Indonesian opportunities than they could acquire through isolated competitive bidding. Whether Canadian taxpayer and consumer interests are best served by such politicized relations is another matter. Some final observations are offered on potential complementarities in future Canadian and Indonesian development, on what it might take to stimulate a broader range of trade and joint-venture operations without the need for ongoing subsidy and on preferential treatment.

The next session on Pacific Rim developments dealt with two broad issues of significance to Canada: the changing economies of the Asia-Pacific region and their impact on Canada; and Canada's interest in forming stronger organization ties with the countries of the Pacific Rim. Roman Lepiesza of the Institute for Research on Public Policy, outlined some of the major structural economic changes currently taking place in the Asia-Pacific basin.[20] Lepiesza noted that since the 1960s the export-oriented countries of the Asia-Pacific have been transforming their economies by shifting output increasingly towards higher value-added production. For many, particularly the resource-rich countries, transformation has meant a significant shift in the structure of output and export from agriculture to manufacturing, while for others such as Japan it has meant a shift in output from the trailing to the leading edge of industrial development worldwide.

Such structural change, which occurred within the span of a single generation, created numerous opportunities as well as challenges for Canada. Exports of Canadian resource products grew rapidly to fill the growing need in the Asia-Pacific region, while imports from there had a significant competitive impact on central Canada. In recent years, however, Lepiesza noted, many of the countries of the Asia-Pacific region have altered their economic structures and trading patterns in response to changes in the international economic environment. The trend in trade within the Asia-Pacific region and with Canada is towards increased imports of fabricated and end products. Japan's demand for raw material resources, for example, has been levelling off and despite increased imports of more fabricated forms, Japan's share of Canadian exports has fallen by 20 per cent since 1977. The share of trade with the resource-rich developing countries of the region has increased and their growing demand for components, technology and capital goods in combination with a changing pattern of import demand in Japan has significant implications for Canada's export prospects as well as for its role in the region's trade. Canada will find it increasingly difficult to penetrate the dynamic Asia-Pacific market, Lepiesza concluded, unless it can quickly diversify its export products from both western and central Canada. As a policy response to the Asia-Pacific economic challenge, Lepeisza suggests a more encompassing export promotion program involving imports as well as exports.

Paralleling Canada's growing ties with the Asia-Pacific Basin has been its interest in a Pacific Community, a concept which calls for the formation of closer economic and other organizational ties with countries not only of the region but also on both sides of the Pacific, including the United States. Michael Fry and Keith Hay note that such a community would require significant measures of commitment, integration and surrender of sovereignty by member countries.[21] Within this framework, the authors question whether the pre-conditions for forming a Pacific Community theoretically exist and, if so, whether the trends are positive. In their paper, Fry and Hay consider factors that tend to increase significantly the interaction levels among countries, with the assumption being that these interactions will foster expectations of reciprocal benefits stimulative of regional or community behaviour. Using an economic approach to community involvement, Fry and Hay indicate that all potential Asia-Pacific community members will have a differing calculus upon which to measure the likelihood of their adherence to a community that would demand more commitment, integration and denial of sovereignty. Despite mounting economic ties with it, the sum total of our current involvement in the Asia-Pacific region, according to Fry and Hay, makes it look as if the area is still at the margin of our economic and strategic thinking. In this regard, the best policy option available to Canada in the medium-term may be the formation of a trading bloc with the United States rather than a larger Pacific Community, which Fry and Hay regard as interesting only as a longer-term alternative.

In the final session of the conference, two papers, for the most part unrelated to each other, were presented under the broad theme of co-operation through self-interest. The first paper by J.W.C. Tomlinson, Ilan Vertinsky and C.F. Smart outlined the nature of the joint-venture mechanism of technology transfer to developing countries.[22] Their study focussed primarily on the structure of joint venture, the reasons for going into such an arrangement, major issues to consider in the formation of a joint venture, and the limitations of the joint-venture format as a mechanism for the international transfer of technology. The authors reveal that from the foreign investors' point-of-view, joint venture can be desirable for a number of reasons, including complementarity of local resources and facilities, host government incentives, risk spreading, return on investment, entry into a market or attaining a certain level of market share. From the recipient country's point of view, the joint-venture mechanism is often viewed as a major vehicle not only for the sake of investment and employment but also to educate and train its workforce in several technical and management fields. Although there are several costs and benefits associated with this mechanism of technology transfer, the authors, after reviewing the results of a number of case studies on Latin American countries, conclude that there is a "commonality" of mutual interest between the transferer and the recipient of technology in a joint-venture arrangement. Tomlinson and Vertinsky view this commonality as a commitment which points to a convergence in the attitudes of both experienced foreign investors and host-government authorities vis-à-vis the positive nature of joint venture in general, even if their motivations may be different.

The final paper, by Gordon R. Munro, focussed on the economics of co-operative fisheries arrangements. The Third Law of the Sea Conference has had a major revolutionary impact upon the management of world fisheries. Coastal states such as Canada have, as a consequence of the conference, acquired control over large fishery resources which hitherto lay beyond national jurisdiction. Thus, one can maintain that the Law of the Sea Conference has created a new set of potential trade relations for Canada and other coastal states.[23] Key policy questions in this regard are being debated, such as whether Canada should co-operate with other nations to manage and develop these resources or whether it should seek to Canadianize the industry. Seeking an answer to this question, Munro examines the economics of co-operative fisheries arrangements, which he defines as a blend of economic fisheries management and international trade considerations.

The economic arguments in favour of co-operative arrangements, according to Munro, prove to be no more than variations on the argument for free trade. Similarly, the arguments from within the coastal states against the arrangements are seen upon inspection to be an argument in favour of protecting various sectors of the coastal-state fishing industry. Munro noted that Canadian policy towards co-operative fisheries arrangements has, from the inception of extended fisheries jurisdiction, tended to be strongly protectionist, in large measure attributable to the strength of the employment argument for protection in Atlantic Canada, the region most heavily influenced by extended fisheries arrangements. Yet protectionism can also be attributed to the common property nature of the fisheries, a property which has acted as a constant and ongoing ban to the effective management of fisheries.

Summary and Conclusion

Overall, a number of central issues emerged in both plenaries, in the dinner speech and in all the papers, reflecting the interdependence of the global economic system, the high level of government involvement and intervention in the domestic economies, and the shrinking distinction between the domestic and the international policy spheres. The prime concern echoed throughout was the need to strengthen the existing rules and to extend international co-operation to new areas currently outside the explicit regulation of existing institutions in order to reduce uncertainty and instability in the international trading system. Underlying this concern was the recognition of the interdependence of trade issues as well as those issues involving trade, international investment, exchange rates, and global debt. Canada has a major role to play in this area, as well as some major decisions to make in coming years.

Notes

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2. Theodore Cohn, "Canadian and Mexican Trade Policies Towards the United States: A Perspective from Canada", Chapter 1, Canada and International Trade.
3. J. Christopher Thomas, "Conflict Over the Extraterritorial Application of US Antitrust Law: A Canadian Perspective", Chapter 4, Canada and International Trade.
4. D. Cohen, "The Intersection of Consumer Protection Law and International Trade: Implications for Canadian Regulators", Chapter 5, Canada and International Trade.
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6. Michael Webb and Mark Zacher, "Canada and International Regulation of Primary Commodity Markets: The Case of Minerals", Chapter 6, Canada and International Trade.
7. D. Haglund, "The West's Dependence on Imported Strategic Materials: Implications for Canada", Chapter 7, Canada and International Trade.
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9. Debra Glassman, "Exchange-Rate Behaviour and the Future of the Managed Float", Chapter 8, Canada and International Trade.
10. Robert K. Paterson and Michael B. Hicks, "Official Export Financing: A Canadian Legal Perspective", Chapter 10, Canada and International Trade.
11. John M. Curtis, "Canada, the International Monetary Fund, and

Exchange-Rate Policy", Chapter 9, Canada and International Trade.

12. Frank Langdon, "Canada and the Internationalization of the Japanese Economy", Chapter 11, Canada and International Trade.

13. Malcolm Smith, "The Internationalization of the Japanese Economy: The Legal Framework", Chapter 12, Canada and International Trade.

14. Samuel P.S. Ho and Ralph W. Huenemann, "China's 'Open Door' Policy", Chapter 15, Canada and International Trade.

15. Robin M. Elliott, "The Economic Contract Law of the People's Republic of China: A Window on China's Legal and Economic Worlds", Chapter 16, Canada and International Trade.

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19. Geoffrey B. Hainsworth, "Innocents Abroad or Partners in Development? An Evaluation of Canada-Indonesia Aid, Trade and Investment", Chapter 13, Canada and International Trade.

20. Roman Lepieza, "Canada and the Changing Economy of the Asia-Pacific Basin", (Institute for Research on Public Policy, forthcoming).

21. Michael Fry and Keith Hay, "Canada and Organizational Developments Among Pacific Rim Countries", A Paper Presented at the IIR-IRPP Canada and International Trade Conference, Vancouver, 5 June 1983.

22. J.W.C. Tomlinson, I. Vertinsky and C.F. Smart, "Transfer and Control of Foreign Technologies: Policy Analysis and a Latin

American Case Study", Chapter 18, Canada and International Trade.

23. Gordon R. Munro, "Canada, International Trade, and the Economics of Co-operative Fisheries Arrangements", Chapter 17, Canada and International Trade.

CANADA AND THE PACIFIC RIM

11: CANADA AND THE INTERNATIONALIZATION OF THE JAPANESE ECONOMY

Frank Langdon

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CANADA AND THE INTERNATIONALIZATION OF THE JAPANESE ECONOMY

Introduction

"Internationalization" has become a popular term in Japan; it calls for closer integration with the western industrialized world of Canada, the United States and Western Europe. It is a new term for Japan's century-old campaign to catch up with, and now perhaps to surpass, advanced Western countries. In the last five or ten years, as Japan has drawn economically abreast of such leaders as the United States and West Germany, "internationalization" has taken on a new twist. It is being applied internally by opening up the Japanese economy to foreign products, services and investment. At the same time, Japanese investment increasingly is moving abroad, and the yen is evolving into a global currency. For the first time, Canada, the United States and Europe are compelled to go beyond an appreciation of Japanese culture or the martial arts, and to come to grips with the real challenge of Japan today--to penetrate its domestic business environment with quality competitive products, as it does in the other advanced countries of the Western world.

Despite its striking success in establishing a strong global presence through trade and investment, Japan remains nevertheless a relatively isolated, homogeneous society with few immigrants and a strong native social tradition with which foreigners find it difficult to cope. However, it is slowly yielding to Western pressure to further

welcome foreign exports and investment, and thus to internationalize internally as well as externally. Prime Ministers Ohira, Suzuki and Nakasone have all urged their officials and businessmen to ease the entry of foreign products and foreign capital. In December 1981 for example, the Japanese Cabinet adopted a five-point package for simplifying import procedures and product standards, and responded to the international concern with Japan's large trade surplus by building up emergency oil stocks and increasing its purchases of military aircraft from the United States.

Ninety-nine complaints listed by the United States and the European Community about restricted entry to the Japanese market were accepted by the Japanese Cabinet in January 1982, and steps were taken to ease the entry of foreign products. To ensure that Japanese officials co-operated fully in this policy, an ombudsman system to monitor trade complaints was set up under Nobuhiko Ushiba, a former ambassador to Canada and the United States and a leading trade negotiator. Tariff reductions were announced before Prime Minister Suzuki attended the Versailles summit in 1982 and before Prime Minister Nakasone visited Washington in January 1983. Japan has therefore moved in advance of its Western trading partners with respect to Tokyo-Round tariff reductions. The average level of tariffs in Japan is 2.7 per cent, compared to 4 per cent in the United States and 5 per cent in the European Community.[1]

The Japanese government appears to be pressing for further trade liberalization and is now pushing for a new round of multilateral trade negotiations to reduce tariffs to zero and ease non-tariff barriers. This move is designed to lessen some of the severe trade friction of the past several years when Japanese exports such as automobiles, motorcycles, television sets, videotape recorders and cameras continued to sell very well in North America and Europe while the manufactured exports from the latter, many of high quality and technical sophistication, declined in volume or sold poorly in Japan. To facilitate the sale of foreign imports to Japan, the Federation of Economic Organizations ("Keidanren"), the leading business association of Japan, has strongly supported government steps to help foreign companies export. It urges the "internationalization" of domestic financial and capital markets to bring in foreign investment and participation on an enlarged scale.[2]

Despite the touting of Japanese tariff reductions and special market-opening efforts--apparently designed to keep the United States Congress from passing some damaging protectionist legislation against Japan--there has been almost no effect on trade patterns with the Western countries and virtually none with respect to Canada. British Columbia has pointed to such trade complaints as the use of administrative guidance by the Japanese government in setting prices offered for herring roe and establishing quotas on fish products. Canada continues to protest tariffs on refined non-ferrous metals and excessive health and safety standards. With respect to Japanese imports of foreign automobiles, there are no tariffs, but the cost of modifying the cars to meet Japanese standards or inspecting them usually doubles their price. Even if they were competitive in price, the large size and gas consumption of many American cars would probably not appeal to Japanese buyers.

The ineffectiveness, or only marginal impact, of the so-called market-opening measures by Japan is explainable. American and European politicians are calling for market-opening gestures by the Japanese to mollify domestic critics wanting protectionist action against competitive Japanese exports. The undervalued yen and overvalued dollar have greatly lowered the cost of Japanese exports and increased the cost of imports, the latter already down due to recession and depressed Japanese domestic demand. Even if there were no big price differential and Japanese domestic prosperity existed, the high-productivity export sectors of Japan would probably still sell well both at home and abroad, to the detriment of similar foreign products. If Japan were to do more than its Western partners and undertake some extraordinary measures to abolish virtually all normal tariffs and quotas, and suspend inspections and standards, it is not certain that this would produce a more closely balanced merchandise trade. It is hardly surprising that the Japanese government is reluctant to go beyond those steps that just suffice to calm the outcry against Japan in North America and Europe, given that the situation is a result of the world recession, US fiscal policies and Japanese competitiveness, for which Japan should not be the scapegoat.

Canada-Japan Trade

Unlike most other Western industrialized countries which predominantly export manufactured goods, Canada has enjoyed favourable entry to Japan for its raw material and primary manufactured exports over the last 60 years, the war years excepted. Before the war in the Pacific, Canada even had a healthy trade in motor cars and electrical machinery, although the total trade was small in comparison with the United Kingdom and the United States, Japan's major partners at that time. Merchandise trade with Japan was developed largely by Japanese businessmen rather than Canadians so that the commercial marketing base in Japan for Canada has remained small. Although Japan is Canada's second largest trading partner, it receives only 5.2 per cent of Canada's total exports; goods from Japan constitute 5.1 per cent of Canada's imports.[3] Of Japan's imports, 3.4 per cent are from Canada and of its exports, 2.1 per cent go to Canada.

During the Trudeau years, Canada tried to increase the relative proportion of trade going to Japan, especially in the manufactured category, to the extent that trade agreements and exhortations of ministers could accomplish this. Both federal and provincial governments have sponsored many delegations of businessmen and officials from Canada to Japan in order to spur trade.[4] Ontario, Quebec and Alberta have small offices in Tokyo for the same purpose.

High barriers are not the reason for the poor export of Canadian manufactured goods to Japan, at least not in those sectors where Japanese productivity is high (i.e., automobiles, television sets, video recorders, cameras, watches and steel). In those sectors, Japan can usually undersell similar Canadian products in Canada's own market. Often Japan will import similar, even cheaper, manufactured goods from the "newly industrialized countries" such as South Korea, Taiwan or Hong Kong. The United States and the European Community have the same difficulty competing in these sectors in Japan, which they complain does not import sufficient manufactured goods. The problem facing all countries attempting to export into Japan is that it is a very demanding market, and one that emphasizes service and follow-up. On top of this are the Byzantine complexities of the Japanese distribution system and business practices that stress the value of long-term commitments. For the Canadian exporter, there is the added challenge of having to break out of the long-familiar North American market and invest in the preparation and product adaptability required for Japan.

Even when Japan does not produce a certain product, there may be reasons why it will not sell in Japan. One reason is the desire of Japanese producers to develop a product for themselves and for future export. Another may be a lack of confidence in Canada's expertise. A case in point is the attempted sale of the Canadian nuclear power reactor--the CANDU--which almost succeeded. This heavy water reactor is superior in design and operation to the US light water reactors used by Japan. The CANDU was enthusiastically supported by the Japanese Ministry of International Trade and Industry (MITI) and its government-owned Electric Power Development Company, which tested its use in earthquake-prone Japan. The Canadian reactor would have been built with Canadian credit and uranium fuel supply guaranteed for 30 years. In 1978, the Japanese trade minister, Masumi Esaki, hoped the reactor sales would also aid Japan in obtaining other fuels from Canada such as gas, and eventually, oil. The Canadian sale would also free Japan from dependency on the United States for enrichment and nuclear technology. In short, it would diversify Japan's sources of fuel and technology, a leading objective of its economic security policy, particularly in the energy sector which proved to be so vulnerable in the 1970s. Therefore, why was this unique Canadian opportunity lost?

It was not for want of a Canadian effort. Atomic Energy of Canada Ltd., the CANDU's maker, is owned by the federal government, and Prime Ministers Pierre Trudeau and Joe Clark lobbied in its behalf to their Japanese counterparts. The Canadian company keeps a representative in Japan, and the Japanese trade ministry has continued to appropriate funds to test the Canadian technology. However, the rival Japan Power Reactor and Nuclear Fuel Development Company, backed by the Science and Technology Agency, is developing its own heavy water reactor. The Japanese Atomic Energy Commission, in a crucial decision on 10 August 1979, brought down the advice, accepted by Prime Minister Ohira, that there was no valid reason for introducing the CANDU. This decision was backed by much of Japanese business, which wished to see Japan even more independent of foreign technology by developing its own new reactor types. Despite the merits of the Canadian technology, fully acknowledged by the Japanese Atomic Energy Commission, Japan decided to produce a reactor of its own design at greater expense and cost of development time in order to attain greater economic independence. Such nationalistic and commercial motives are understandable; Canada has them as well. In this case, Canadian expertise was appreciated by both Japanese government and industry and some hope remains on the Canadian side of an eventual reversal of the decision against the CANDU, as the trade ministry continues to receive funds to test the Canadian technology.

There has been an increase in the relatively small, highly-manufactured exports from Canada to Japan, which have recently included telecommunications and computer equipment. In 1984, Northern Telecom's American subsidiary, Northern Telecom International, succeeded in selling 60,000 touch-tone telephones to Nippon Telegraph and Telephone Public Corporation. This was one of the outcomes of a long campaign by the United States to open the procurement of Japanese government-owned corporations to foreign bidding. It was, nevertheless, only a moderate amount of hyperbole for J.E. Newall, chairman of Du Pont Canada, to say at the Canada-Japan Business Co-operation Committee (CJBCC) that, "Japan is the only developed country market in the world where Canadian exporters of manufactured goods have met with virtual total failure."[5] The Canadian trade minister who attended the committee's previous year's meeting had appealed to the Japanese businessmen present to favor Canadian manufactured products.[6] This is only one recent example of the exhortations by Canadian ministers, going back to at least 1970.

The minerals, agricultural and forest products sectors have grown fastest and constitute the biggest share of Canada's exports to Japan. In order to acquire those raw or processed resource products that are needed by industry yet are in such short supply within their own country, Japanese traders and producers have eagerly come to Canada. Even when domestic demand slowed sharply and producers had to cut back acutely on their imports from Canada, Japan's basic economic security policy called for maintaining good relations with such major resource suppliers as Canada, which continues to be an alternative source of essential raw materials.

The agricultural sector, to which Canada exports large amounts of wheat, barley, rapeseed, meat and fish, is the one area in which most of Japan's stringent quotas are maintained. It is also a highly protected sector in Canada, the United States and the European Community, and the General Agreement on Tariffs and Trade is least applied to agricultural goods. Rice is excluded from foreign sources, although in July 1984 the Japanese Food Agency had to ask South Korea to return some rice loaned to it earlier because the 1978 carryover crop was badly contaminated with bromine. The subsidized Japanese rice farmers receive far above world prices and sharply oppose any foreign imports. Japan is Canada's fifth largest market for wheat, and the United States' biggest market for its agricultural exports in general. The United States has, nevertheless, orchestrated an unending campaign to force Japan to take larger quantities of beef, citrus fruit and tobacco products in the vain effort to offset its enormous and ever-growing trade deficit with that country. In part, this huge bilateral deficit is due to weak Japanese domestic demand, but the central culprit has been the strong dollar, resulting from US military and economic policies which produce high interest rates and a low exchange value for the yen. Consequently, the prices of Japanese exports have declined about 30 per cent in dollar terms from 1979, a situation that vastly stimulates their demand in the United States, and further depresses Japanese demand which is already slowed down by the continued recession at home. Negotiations in 1984 have increased US citrus and beef quotas in Japan. Although Canada could supply more beef, most of the quotas go to Australia and the United States, to whose pressure Japan is more vulnerable as they are more important trading partners than Canada. Canada has done fairly well under variable quotas for dressed pork, but will probably have to take a reduced share of the Japanese market due to the return of Denmark, which was excluded because of disease in the industry until 1984.

With respect to forest products, successful private sector lobbying by Canada in the 1970s resulted in a new building code for two-by-four construction and new agriculture standards for softwood and plywood in Japan. These regulation changes have facilitated greatly the use of Canadian standard lumber. Japan's 10 per cent tariff on dressed whitewood lumber from Canada has held firm, however, despite Canadian requests that it be lowered. The tariff affords some protection to acutely-depressed Japanese sawmills, which are mostly small operations. However, Japan has eased the regulations for use of plywood, as Canada has requested.

Rather more problematic is the situation faced in Canadian energy exports such as coking coal, oil and natural gas. Coking coal--Canada's most valuable export to Japan--has been exported in decreasing amounts in the early 1980s due to the slowdown of the Japanese steel industry, which has been producing at only 60 per cent of capacity. In 1984, five new mines are coming on-stream in Canada as well as others in Australia in order to supply an extra 20,000,000 tonnes a year; existing mines in Canada are being asked to cut back by 30 per cent on production, all for the same steel companies. With pessimistic forecasts of continued weak demand for the rest of the decade, it appears that a vast oversupply of coal is developing just when expensive new mines have been financed with difficulty by international banks, the British Columbia and federal governments, and minor participation by the steel companies. There is still only a relatively small market for Canadian coal in South Korea and Taiwan so that it will be extremely difficult for all the mines to remain open.

The Japanese steel companies have already negotiated reduced prices as well as export volumes with the existing mines, so that the struggle is now to cover costs.

The decision to encourage new mines in Canada was the result of lengthy strikes in 1980 in both Australia and the United States, which compelled the Japanese steel makers to resort to the spot market in an effort to keep mills operating. They also insisted on the opening of a new coal port near Prince Rupert to ensure shipments from more than just the lower mainland of British Columbia. While coal shipments from the United States to Japan have been reduced, the lion's share held by Australia has been maintained, even though larger shipments from Canada have been planned. Only an upturn in Japanese steel demand can ease a very serious situation for Canadian exporters. Japanese industry also faces a challenge from cheaper Korean steel in its own market, as well as protective measures in the American market, which will depress demand further.

Although Japan's energy policy has planned for increased use of steaming coal, the need has become less pressing with the recent oil glut and falling energy demand. Unfortunately, British Columbia steaming coal appears to be ill-suited for Japan's electric utilities. The Japanese emphasis upon nuclear energy continues, with unflagging construction of new electric generating plants and a new reprocessing, enrichment and waste-storage complex to start in 1986. The cost per kilowatt for electricity from nuclear plants in Japan remains cheaper than that from the use of coal, oil or liquefied natural gas. This ensures a continued Japanese demand for Canadian uranium exports.

Ever since the oil crisis of 1973, Japan has been anxious to diversify its source of oil since it remains dependent on exports from the volatile Middle East. Although Canada's policy is to export oil when it becomes surplus to domestic needs, that condition is unlikely soon. Domestic production continues to decline and Canada imports more than it exports. However, buoyed by federal hopes of self-sufficiency by 1990, Japan had thought Canada might soon be able to export large amounts. It has participated on a modest scale in developing new methods of extracting oil from the Alberta tar sands, and the Japan National Oil Company financed drilling in the Beaufort Sea by Dome Petroleum to the tune of $400,000,000 in 1981 and 1982. The funds are to be repaid with future oil production if Canadian government policy changes to permit export in significant amounts in the future. Otherwise, the principal is to be repaid in cash in 2030.

Thus far, Dome has not discovered promising oil deposits in the Beaufort Sea. Since Dome is in a precarious financial condition due to difficulties in renegotiating its enormous debts with Canadian and international banks, numerous exaggerated stories have appeared in the Japanese press and periodicals decrying the association with Dome. Consequently, a garbled report in February 1984 when the Japanese trade minister told the Diet (Parliament) in Tokyo that no further funds would be invested in Beaufort drilling by Dome, led to the temporary halt of trading in Dome shares in Toronto. The reports indicated that the funds were lost, which was incorrect given that the Japanese had already fulfilled contracted obligations.

Perhaps to counter the effects of the unfavourable publicity of early 1984, the Canadian National Energy Board permitted small quantities of oil to be shipped by Dome to Japan from the West Coast. The good grade of Alberta oil is temporarily in excess supply, hence this does not represent any basic change by the federal government in its policy for allowing significant amounts of oil to be exported. Nevertheless, as late as August 1982, reports appeared in the Japanese press that large amounts of Canadian oil would be available by 1986.[7] These are without foundation.

Much more important with respect to change in the trade pattern is the large amounts of shut-in natural gas that the National Energy Board considers to be in excess to future Canadian needs. Dome signed an agreement with Nissho Iwai, Japan's fourth largest trading company, to export liquefied natural gas by 1986 to five Japanese power companies, led by Chubu Electric Power Company which will take half of the 2.9 million tonnes a year contracted to for 20 years. This will add a large new item to Canada's trade with Japan, while also reducing reliance upon the United States as the sole foreign buyer of Canadian gas.

The protracted negotiations of Dome's debt problems have delayed the project, as has the process of getting provincial and federal approvals to supply the gas. Chubu Electric has extended its deadline, but has called for arrangements in Canada to be completed by October 1984, when Dome must have financing in order for the new line to be built north of Prince Rupert, as well as its own finances. Although Union Oil Canada, Ltd. has agreed to take a 10 per cent interest to match Nissho Iwai's 10 per cent in the LNG project, additional partners are needed to ensure the arrangements are successful. A positive outcome is far from clear in the summer of 1984.

Changes related to the structural adjustment taking place in Japan are also opening up new opportunities for Canadian secondary manufacturing. The most significant development in this respect is the desire to transform Japan into a "knowledge-intensive" society centered upon the high value-added range of production. As a consequence, those areas of little or no Japanese comparative advantage (the low end of metal refining, petrochemicals, textiles, shipbuilding and the like) are being phased out, opening up new opportunities for foreigners. Canada's rich mineral deposits and its cheap sources of energy make it ideally suited to fill this gap, and thus to upgrade the value-added of its own exports to Japan. At the same time, it is hardly unique in this respect and can expect competition from Australia, Indonesia, Brazil and others. A similar picture is to be found with respect to processed foods: though Japan's high consumption society offers a broad market which Canada should readily be able to service, competition from the United States and Australia, amongst others, suggests that Canada will need to push vigorously for its share.

Turning aside from the current struggle to retain the long-standing favourable entry to Japan of Canada's major commodity exports, there is the possibility of future gains for Canada in the services sectors. Provincial officials have noted that, "As a result of foreign demands to open its market to imports, an increasing internationalization (and appreciation) of the yen, the growth of Tokyo as a financial centre, renewed energy price growth, and increased domestic demand as the recession subsides, Japan presents an exceptional market for Canada."[8] Strong pressure on Japan from the United States to open its financial markets, as well as communications system, to greater foreign penetration is slowly yielding some significant results.

In line with Reaganesque supply-side economic policies, the US government believes that greater internationalization of the yen as a consequence of reduced Japanese government controls will result in heightened foreign use of the Japanese yen, or yen-denominated instruments, and a consequent rise in its value, resulting in some relief to the unbalanced trading pattern. For instance, certificates of deposit are now allowed to be issued in smaller denominations than before, and foreign banks in Japan have been permitted to issue them. Most earth-shaking was the decision to allow Japanese banks to issue yen-denominated bonds abroad for the first time on 1 April 1984. These issues have no collateral restrictions abroad, while they are onerous in Japan. The yen has thus been linked with the Eurocurrency markets which are free. The United States is now pressing for permission for foreign resident institutions to issue such bonds. Vice Finance Minister Oba, after talking to the Prime Minister, has considered not only opening this business to foreigners, but lifting the ban on medium- and long-term Euroyen bank lending and issue of yen-denominated certificates of deposit in the Euromarkets.[9]

Greater internationalization of the yen promises increased borrowing abroad at favourable rates by Japanese business, which will bring pressure on lending within the country and on finance officials to ease their controls over Japanese interest rates and lending regulations. The European Community pressed, in its request of November 1983, for abolition of Japanese government intervention in the movement of interest rates, and for loosening of the issuance of certificates of deposit. In the May 1984 ministerial talks it also discussed liberalizing the sale of national bonds by foreign banks and creating a bankers' acceptance market. If Canadian banks in Japan can take advantage of this trend which now seems to be gathering momentum, Canadian business will become more integrated with the conduct of Japanese domestic and international financing. Thus far, Canadian banks have been too limited in loans and trade financing, dealing only with Canadian companies. Much more Canadian investment in Japan is needed to facilitate trade and commercial relations generally between the two countries.

Perhaps more important than the internationalization of Japan's financial system is that of the communications system, a sector where Canada, in certain aspects, has a prominent place as a world leader. The Japanese Cabinet approved a series of bills in April 1984, ending some of the monopoly of the Nippon Telegraph and Telephone Public Corporation and liberalizing and internationalizing information network services, or value-added network (VAN) services as they are called in Japan.[10] This change is a result of what is already occurring in the United States telephone and information industry, and a product of US pressure coming from its endless trade frictions with Japan.

The emerging new information industry will permit users to interact directly from remote terminals with one or more computers and associated data banks, or from one facsimile terminal to another, regardless of protocol compatability. Companies other than Nippon Tel will be able to operate their own phone and information tie-ups, or sell the service for using them. This will apply to communication between cities as well as companies or small private users. The Network Business Association, under Mitsui and the Industrial Bank of Japan, hopes to introduce American Tel's network system ("Net 1000") as one of the entrants to large-scale network services.

The Ministry of Posts and Telecommunications wants to keep tight control over the new network services system, while the Ministry of International Trade and Industry would like to permit free access. A fair degree of foreign participation in providing both equipment and services seems likely. As Canadian companies such as Mitel and Northern Telecom have already provided equipment to Nippon Tel, there should be further opportunity for Canada, whatever arrangements eventuate from the current era of turbulent change in services. There is some sharp opposition by the Agency for Cultural

Affairs with the trade ministry over protecting computer program rights. The United States has strongly protested the ministry's legislative proposals for limiting software developers' exclusive use to 15 years, as they are protected for 50 years under copyright law in the United States.[11]

While domestic liberalization has opened up Japan to many more global influences, internationalization has also involved certain external aspects. Though Japan's heightened concern for the Third World and its more vocal diplomatic commitments are significant developments, the surge in foreign investment by the Japanese is most relevant to Canada. This is notably the case because Japanese investment in Canada is considered by Canadian officials to be much too low, both in comparison to the trading relationship and as a share of the North American market, with Japan ranking seventh among foreign investors in Canada. The Japanese have typically invested in minority equity shares, and concentrated in the services (merchandising) and resources sectors. Their participation in manufacturing has been largely limited to the forestry industries, and official Canadian interest has been focused on extending this, particularly to the automotive sector. Nevertheless, given the changes taking place in Japan, the energy sector and resource-related manufacturing is where the bulk of Japanese investment in Canada is likely to take place.

Conclusion

In summarizing the effects of the increasing internationalization of the Japanese economy and the net effect for Canada, it can be seen that there are both challenges and opportunities. Canada's position is different from that of the large advanced Western partners, the United States and the European Community (or its major components: Britain, France and Germany). It has a smaller population and economic base, which reduces its relative importance, and it faces relatively little of the trade friction that currently agitates the large advanced partners. Thus, Japan does not feel impelled to respond to Canada to the same extent in its slow and hesitant steps to internationalize by opening up its economy more fully to the outside world. The area of greatest importance to Canada is the historic one of its large commodity trade in resource products and primary manufactures. Its biggest challenge is to meet foreign competition to retain that valuable trade and weather the difficult period in which Japanese domestic demand is reduced by more moderate levels of growth and by internal restructuring. Fortunately, Canada is valuable as an additional source of the many raw materials and processed goods essential to Japan's economic security needs.

Canada's challenges and opportunities are not confined to the commodities sectors. The secondary manufacturing sector is growing modestly and could become greater as a result of the much increased interest throughout Canada in overseas business due to the recession and international interest in the dynamic economies of Northeast Asia, especially Japan. The pressure for Japan to internationalize by opening its doors wider to foreign business, as well as participating more actively through its own business sectors abroad, seems to be having an effect, particularly in the services sectors of banking and communications. There is opportunity to hold our own, and even many gains to be had, by taking advantage of the increased internationalization of Japan.

Notes

1. However, individual tariffs can still be high, as in the case of imported liquors such as Canadian Club or French cognac, so as to protect domestic producers.
2. Liberal Star (Liberal Democratic Party of Japan), "Keidanren Underscores Importance of Preserving the Free Trade System", 13 (10 March 1984), p. 4. See also Tsuguio Ibayashi, "Preserving and Strengthening the Free Trade System", Keidanren Review 85 (February 1984): 9-12.
3. B.C. Ministry of Industry and Small Business Development, Canada-Japan Business Cooperation Committee, (May 1984), 1.
4. Frank Langdon, The Politics of Canadian-Japanese Relations 1952-1983 (Vancouver: University of British Columbia Press,

1983), Chapter 5.

5. Julia Elcock and Wayne Gooding, "Manufacturers will get sale hints from Japanese", Financial Post, 19 June 1982, p. 6.

6. Herb Gray, Speech as trade minister to the Fourth Canada-Japan Businessmen's Cooperation Committee, Vancouver, 18 May 1981.

7. "Japan May be Importing Canada Oil as Early as in '86", Japan Times Weekly, 22 (28 August 1982), p.9.

8. B.C. Ministry of Industry and Small Business Development, Canada-Japan Business Cooperation Committee, 6-7.

9. "Capital Market Action Sought", Japan Times Weekly 24 (21 April 1984), p. 5. Also, "Anticipating Euroyen Troubles", Japan Times Weekly 24 (7 April 1984), p. 6.

10. Gene Gregory, "VANguard of Progress", Far Eastern Economic Review 124 (3 May 1984), 82, 84-5.

11. "Economic Enemies Within", Japan Times Weekly, 24 (13 March 1984), p. 5.

12: THE INTERNATIONALIZATION OF THE JAPANESE ECONOMY: THE LEGAL FRAMEWORK

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INTERNATIONALIZATION OF THE JAPANESE ECONOMY: THE LEGAL FRAMEWORK

Introduction

European and American criticism of Japan's international economic policies has escalated in recent years. Frustration is evident at all levels of Japanese government and business as Japan, in response, alternates between a defence of its recent initiatives and an attack on the economic policies of both the United States and the European Community. The criticisms from the United States, which at one point focused on the basic structure of Japan's foreign investment regime, now include a wide-ranging criticism of all policies that restrict access to Japan's financial markets. By early 1984, these criticisms had become a major plank in high-level negotiations between Japan and the United States, especially in terms of the continuing, drastic imbalance in the balance of payments between the two countries. On 27 April 1984, Japan announced its fifth package of foreign economic policy measures since December 1981 in an attempt to stem the tide of criticism before the June 1984 Economic Summit meeting in London.[1] The policy changes were greeted with the same response as those that had gone before: it was "too little, too late".[2] Finally, an agreement concluded between Japan and the United States on 30 May 1984 heralded a temporary pause to the political debate on yen-dollar exchange-rate issues.[3]

The Japanese can point to significant developments in their own laws in the past three years. In purely legal terms, there have been fundamental revisions of the major laws regulating foreign-investment transactions and foreign-exchange transactions, and the major laws regulating the actors in those transactions; there has also been a wide-ranging review of domestic laws that impact on foreign trade. To the chagrin of the Japanese, these efforts have been met with extreme skepticism by their trading partners. At the core of these criticisms is a deep-seated belief that the laws may change in Japan, but the practices which restrict both trade and investment will continue.

One of the major areas for contemporary political scientists and economists to examine is the extent to which there are real structural changes occurring within the Japanese political and economic structure that explain the recent changes to economic laws. If the support for a more open economy is growing within the Japanese business and government communities, change is likely to be more permanent than if it comes simply as a response to external pressures. More important, it is essential for Western policy-makers to be able to identify those sectors within the Japanese political and economic community that would support change. While we can anticipate continuing protectionist sentiments in the industrial and agricultural sectors, the growing internationalization of the great trading companies since the early 1970s and, more recently, the massive in-roads by Japanese securities companies and banks in international financial markets constitute a basic constituency for a more open Japanese economy. This paper reviews the legislative and administrative changes that have occurred in Japan in the past three to five years, analyzes the criticisms levelled at those changes, and attempts to identify the constituencies in Japan that are supportive of those changes.

Basic Legal Frameworks

Traditional analyses of the legal framework for trade and investment in Japan have concentrated on the major laws and regulations that affect the financial system, the entry of foreign entrepreneurs into the Japanese economic system, and the regulatory system for foreign trade. The Japanese laws move at two levels: first, they identify with some precision the types of transactions that are subject to regulation and define the parties who may legally engage in those transactions; then the laws confer authority on the government to regulate both transactions and parties. The nature of that legal authority to regulate economic activity is one key to Japan's foriegn economic posture. The most important laws are the following: the Foreign Exchange and Foreign Trade Control Law, which was substantially amended in December 1979;[4] the Foreign Investment Law, abolished in December 1979;[5] the Banking Law, amended substantially for the first time in 50 years in April 1982; and the Securities Law.[6] Since the amendments are very detailed, and since they are supplemented by major trade-related amendments to a great many other laws, it is essential to find a focus for discussing the changes.

The issue from which all others follow is whether it is really possible to have a domestic--or municipal--legal framework for economic regulation that would be consistent with a truly international economy. It is significant that most discussions about the "internationalization" of the Japanese economy use that term interchangeably with the concept of "liberalization". In that sense what is meant by "internationalization" is simply readier access by foreigners to the Japanese domestic markets for capital and goods, and services. A listing of the areas still limited to foreign access would be sufficient to measure the degree of internationalization of Japan's economy. However, if the concept is much deeper, and if it is based on an assumption that the Japanese economy will be integrated into an "international" economy, the structure of the "legal framework" in Japan is fundamental and measuring the degree of "internationalization" becomes more difficult. The basic test confronting Japan's trading partners in evaluating changes in the Japanese legal framework for regulation is whether Japan shows any sign of releasing the tight control which it has exercised during the post-war years over the freedom of choice that might otherwise be exercised by foreign entities in entering the Japanese economy and by Japanese entities entering the world economy. The basic policy issue confronting trading partners is whether their demands on Japan in relation to the importation of goods and capital to Japan are consistent with their demands relating to the export of goods and capital from Japan.

If there is to be a legal framework at the national level, does it matter what form that legal framework takes? I believe there are some quite different models available and that identifying the type of model employed in Japan is fundamental to an understanding of the operation of the Japanese economic system. In an attempt to assess the direction in which Japan is moving, and the validity of the criticisms which have been levelled at her, let me briefly sketch two models at opposite ends of the regulatory spectrum which I will apply to the changes in Japan's system over the past five years.

The first model is what I call the legalistic framework for an economy. The legalistic framework allows checks on government intervention at all levels. At the initial rule-making level the legalistic framework ensures full public debate of all policies and consequent rules, whether those rules are initiated at the parliamentary or the administrative level. The legalistic framework demands that all policies be stated in clear, published rules which have the force of law. Those rules should be expressed in such a way that they are self-executing and allow minimum discretion to administrators. The legalistic framework demands that there be speedy and efficient structures for applying the rules, including the right of appeal to a party aggrieved by the application of a rule. Whether the initial appeal occurs within the administrative structure or not, the legalistic framework demands that there ultimately be an appeal to the courts. Legalism demands both fair rules and fair procedures as well as the right to the assistance of a lawyer.

In contrast, there is the discretionary approach to the legal control of an economy. Under the discretionary approach, the general rules may be set in the same procedural environment that operates in a legalistic framework; however, the nature of the rules varies significantly. In the discretionary framework, the rules are enabling, not regulatory. The published rules confer a power on the administrators in general terms and leave to the administrators the discretion to define the content of the detailed rules that will make up the system. Where a system allows maximum discretion, it will establish simplified procedures for decision-making and limited rights of appeal. Even where rights of appeal exist within the administrative structure, it will be limited rights of appeal to a court. Legal assistance is not encouraged. In any event the power of the court to override the administrator will be severely circumscribed in those cases where the rules themselves give the administrator the right to determine for himself the merits of a particular transaction.

A legalistic framework can be used to enshrine a restrictive set of rules that would severely circumscribe transactions with an international element. Equally, the same approach can be adopted to set out detailed, definitive rules designed to ensure freedom of international transactions. On the other hand, a discretionary framework can be manipulated to ensure either an open or closed economy. The major consequences for policy-makers follow:

- It takes a major effort to change the direction of policies established in a legalistic framework. The more formal the rules, the more the process of change becomes politicized. This can be most readily observed in the US System, which I believe is the most legalistic economic system in effect today. In contrast, the direction of a policy implemented through a discretionary framework can be more readily reversed. A simple example of this process would be an administrative transfer of the burden of proof--of establishing that a foregn-investment or foreign-exchange transaction was, or was not, in the "national interest"--from the administrators to the applicants, or vice versa.
- The legalistic framework provides a party dealing with the administrators with a clearly defined list of acceptable and unacceptable transactions, coupled with legally-defined procedures for implementing those transactions. It follows

> that the parties have a clear legal basis for initiating court actions whenever the conduct of the administrators falls outside those rules. On the other hand, the administrators have clear legal grounds for proceeding against parties whose transactions fall outside those rules. Where the regulation of transactions is discretionary, it is far more likely that disputes will be resolved within the administrative process, and the more discretionary the rule, the more likely it is that a "sub-culture" of negotiating practices will evolve.

Once a policy-maker explains the objectives of the program of economic regulation to a lawyer, it is possible for the lawyer to adjust elements of the models I have described to build a regulatory system somewhere along the continuum between the two models. In an ideal international economic system the objective of the domestic legal system would be to ensure full implementation of internationally accepted principles of investment and trade and the legal restriction of conflicting domestic objectives.

The accepted view of the Japanese system is that it is close to the discretionary side of the continuum. Great emphasis has been placed on the discretionary power of Japanese bureaucrats, the futility of law suits to challenge their decisions, and the necessity for even the mightiest Japanese companies to follow the government's administrative guidance. While this view tends to play down the actual extent of laws and ordinances concerning economic activities in Japan, as well as a seemingly characteristic system of extensive consultation between the regulators and the regulated prior to initiating new rules, it is a valid generalization about the pre-1980 structure for trade and investment control in Japan.[7] The importance of the accepted view is that it has provided the starting point for foreign demands for change in the Japanese domestic legal structure. Either implicitly or explicitly, these demands, particularly from the United States, have called for more specific rules, less administrative discretion, and rights of recourse to the courts in trade and investment matters. How has Japan responded?

Recent Changes to Japan's Laws

Foreign Investment

Foreign-investment and foreign-exchange controls were first imposed in Japan in the early 1930s, in response to the Depression.[8] The system was significantly strengthened by the Occupation authorities between 1945 and 1950. The basic laws governing Japan's foreign economic structure until 1980 were put in place during this period. The system was designed for a devastated economy that was not expected to regain a significant position in the international sphere. The legal framework set out a detailed list of transactions that were to be controlled by administrative decree. All foreign exchange and foreign-investment transactions were tightly controlled under this system until Japan achieved Article VIII status under the IMF Agreement in 1963. There followed a series of 'liberalizations' of foreign-investment transactions by administrative decree, beginning in 1964 and concluding in 1975. Industrial sectors were progressively opened to foreign investment until, in the final stage, all sectors were declared open to foreign investment except some five sectors identified on a "negative list". The restricted sectors after 1975 were essentially in the primary production, natural resources, and leather goods areas. These sectors remain on the current US negotiating agenda. Throughout the period 1950-1980 there were no recorded instances of successful legal challenges to the implementation of the foreign-investment structure.

The 1980 Amendments to the Foreign Investment Control Structure

In December 1980 the legal system for regulating foreign investment in Japan was radically restructured. The changes were embodied in amendments to the Foreign Exchange and Foreign Trade Control Law (the Law) which were adopted by the Diet in December 1979.[9] The business and legal communities were given a one-year period of grace to adjust to the new system.

The amendments involved the repeal of the Foreign Investment Law and significant additions to the Foreign Exchange and Foreign Trade Control Law. As yet the new system has had little opportunity to prove itself in practice. But two preliminary observations are possible. The amendments were hailed in the popular press in Japan as a significant contribution to the freeing of foreign investment in Japan. The reports gave the impression that from December 1980 restrictions would be imposed in only a few special areas. They argued that the basis for such changes was the shift in emphasis from a concern with restricting investment to a concern with freeing investment. The system would now provide "positive", not "negative", regulation. In other words, the burden of proof had changed. Investors no longer have to justify their investments, the regulators have to justify a restraint.[10]

As will be seen below, virtually all forms of investment will still require official notice, of one type or another, to the Japanese authorities. Further extensive opportunities are provided to the government to take action in specific cases. By balancing these requirements, the new Law embodies for the first time the extensive administrative criteria that must be applied by the authorities whenever they seek to restrict investment. Foreign observers of the old system had frequently pointed out that it was essentially beyond the reach of the courts, since the discretions were cast in very broad terms and few criteria were presented to control the exercise of those discretions. A wide range of economic criteria were henceforth set out in the following articles: 1, 9, 21(2), 23(2), and 27(1); and in article 2(1) of the Supplementary Provisions appended to the Law.[11] These criteria are reproduced in Appendix 1. No legal challenge to any decision can be mounted in the courts until all administrative remedies have been exhausted.[12]

Outline of the New System

In broad terms the new system divides investments into several categories and constructs control measures accordingly.

i. Designated Protected Companies. The government retains the power to designate certain companies and place them beyond the reach of foreign investment. These companies fall into two categories: those enterprises protected by specific laws, such as laws governing mining, banking, and insurance;[13] and those companies designated under article 2 of the Supplementary Provisions, also enacted in December 1979. The Supplementary Provisions allow the government to identify certain companies in which investment may be limited to a specified level and no investment may be made unless a prior report has been provided to the government. The government, upon receipt of the report, must determine whether to approve or reject the investment by reference to criteria set out in the section. Eleven companies were designated immediately prior to the enforcement of the Law in December 1980. The majority were in the oil refining or electrical goods sectors. A major controversy over the designation of one of those companies--Katakura K.K.--including the initiation of a law suit by the aggrieved foreign party against the ministry, has dissuaded the government from making any further designations, although several companies have sought to have their names added to the list.[14] These provisions were reportedly repealed on 18 May 1984 in response to objections by the United States as part of the dialogue associated with the Yen-Dollar Agreement. The criticism of the system no doubt made it a negotiable point in the eyes of the Japanese.

ii. Specific Control of "Direct Investment". The Law creates a second category of investments, defined in article 26 as "direct investments". This article provides that the acquisition of more than 10 per cent of the capital in a domestic company is a direct investment and also that the establishment of a branch office is a direct investment. Article 29 includes transfers of technology within this category. Foreign investors are under certain restraints in relation to direct investments. There must be a prior report in relation to the proposed investment and the investor must wait thirty days before acting. Within that period the government may request a further four-month delay to allow it to carry out an investigation. The government is authorized to reject the investment by applying criteria set out in articles 27 and 29. The government may make recommendations to limit or vary the proposed investment.

iii. Other Capital Transactions. Investments that do not fall under article 26 will be regulated under the category of capital transactions governed by articles 21-25. Two types of regulation are spelled out in these provisions. Transactions that fall within the scope of article 21 require the express approval of the government through a licencing system. Examples are transactions between residents and non-residents that affect claimable rights, such as overseas deposits by Japanese residents, or transactions in foreign currencies other than by Foreign Exchange banks, or the acquisition by foreigners of yen-denominated securities. The criteria for rejection of an application are set out in article 21(2). Capital transactions that do not require a licence may require prior notice under article 22, so that the applicants must wait 20 days before proceeding with the transaction and, again, the government may refuse or challenge the transaction on the basis of the criteria set out in article 23.

iv. Unregulated Transactions. As may have been surmised already, there are an extremely limited number of unregulated transactions in the sense that they require no notice, no licence, or are not subject to the possibility of rejection. Small loans that do not exceed the limits set out in article 26(2)(6) may be executed immediately, but notice must be given. Also, transactions in corporate securities constituting less than 10 per cent of the company may be executed immediately in those circumstances where the aggregate foreign shareholdings in that company do not exceed the limitations set out in article 25. These transactions must, in any case, be reported. The only important category of transaction that may be carried through without the requirement of either a waiting period or a report is a transaction in securities carried out through a designated securities company.[15] In that situation, the investment is regulated indirectly since the transactions of the securities company itself are subject to scrutiny.

The New System in Operation

i. Equity Investment Involving Management Control. It is clear that the direction of government regulation in Japan has moved from considerations of foreign exchange and balance of payments to considerations of the preservation of Japanese management control. As a general proposition, all investment that might affect management control is still subject to the possibility of rejection by the government. As has been mentioned, certain key industries are specifically regulated by individual laws.

Eleven companies are regulated under the 1979 Supplementary Provisions. In general, foreign investment in these industries cannot exceed 25 per cent, or 50 per cent in the case of petroleum companies where foreign investment levels already exceed 25 per cent. Finally, any investment involving more than 10 per cent of the capital of a Japanese corporation is deemed by article 26 to carry with it the possibility of a change in managerial control. All investments above this bench-mark must follow the procedures for prior reporting, potential government investigation, and potential government rejection or variation.

The new law does not appear to have resulted in a flood of direct foreign investment involving management control. The latest figures available indicate that in the April 1983-February 1984 period, the Foreign Capital Division of the International Finance Bureau of the Ministry of Finance received notification of 1974 cases of direct foreign investments to a value of $764 million.[16]

ii. Branch Offices. Until 1980, branch offices were not controlled under the foreign-investment structure, but were regulated under the foreign exchange provisions of the Foreign Exchange and Foreign Trade Control Law. The 1980 amendments now include branch investments as a variant of "direct investments", which are controlled by articles 26 and 27. Accordingly, a branch investment must follow the prior notification procedures and is subject to the possibility of a four-month delay, during which an investigation is conducted--with the ever-present possibility that the proposal may be varied or rejected under the terms and criteria set out in article 27.

iii. Portfolio Investments. Any portfolio investment that exceeds 10 per cent of the capital of the issuing company will be regarded as a direct investment and will be regulated by articles 26 and 27. Portfolio investments involving less than 10 per cent of the issued capital of a company will be regulated by article 22 and will require prior notice and a twenty-day waiting period. There is, once again, the possibility that the proposed investment will be refused or varied on the basis of the more limited criteria set out in article 23. Only where the transaction is effected through a registered securities company will a portfolio investment escape regulation under the new arrangements.

In contrast to direct foreign investments involving management control, there has been a very large turnover in portfolio investments under the new regime. In the April 1983-February 1984 period, non-residents bought stocks to the value of $31,942 million and bonds to the value of $39,840 million. In the same period, non-residents sold stocks to the value of $29,815 million and bonds to the value of $28,066 million. This resulted in a net in-flow of almost $4,000 million. In contrast, Japanese residents purchased stocks overseas to the value of $2,020 million and sold stocks to the value of $1,176 million. They purchased bonds to the value of $23,496 million and sold bonds to the value of $10,927 million.[17]

iv. Technology. Technology investments have always been regarded as a form of foreign investment in Japan. Under the new arrangements, technology transfers are regulated in "direct investments" under article 26 and articles 28 and 29. Since they are direct investments, there must be prior notice, a thirty-day waiting period and the possibility of a four-month investigation. Article 29 sets out slightly different criteria under which the government may vary or reject an application for an investment involving technology. In the April 1983-February 1984 period, the Ministry of Finance received notification of 1976 cases of foreign technology licence contracts.[18]

v. Loans. Small loans will be automatically approved under article 22 up to the amounts specified pursuant to article 26(6), at which point the loan becomes a "direct investment" and is subject to the system governing those investments.

The Operative Criteria

It is obvious from the above analysis that the criteria now governing the government's decisions in each of the key areas of investment will be of vital importance. The criticism that this whole area was a matter of arbitrary government control in the past may now be invalid. Although there are few cases that indicate the attitude the courts might adopt when requiring government officials to operate within the limits of these criteria, the decision of the Tokyo District Court in 1969 in the Cocom case may assume more importance.[19] There, the court overruled a decision of the Ministry of International Trade and Industry (MITI), which had refused permission for the plaintiffs to export certain goods for exhibition at Chinese trade fairs because the goods were included on the Cocom list. The court applied a limited interpretation of article 47 of the Foreign Exchange and Foreign Trade Control Law,[20] concluding that the only relevant criteria that could be used to justify a refusal of an export licence were economic criteria. The court therefore rejected the government's arguments, which were based on military and strategic considerations. Since 1980, the courts have acquired extensive principles to apply in evaluating foreign-investment decisions, and, as mentioned above, a challenge has already been mounted under article 2 of the Supplementary Provisions in relation to the designation of the Katakura company. Will these criteria be given legal definition in the courts, or do they actually preserve administrative power in the area?

Article 1 of the new law is an extensive revision of the previous article bearing the same number.[21] The old references to the "rehabilitation and expansion" of the Japanese economy that had been in the Law since 1950 have disappeared. The new article 1 now asserts that the law is founded on the "basis of the freedom of foreign exchange, foreign trade, and other external transactions", subject to minimum controls or adjustments demanded by the "proper expansion" of Japan's external transactions. The objectives of the law are to "facilitate the equilibrium" of Japan's balance of international payments, to "facilitate the stability" of Japan's currency, and to contribute to "the sound development of Japan's national economy". The remaining provisions of the Law define "the necessary, but minimum control or adjustment" that might be compatible with the basic concept of freedom of transactions. Article 1 encapsulates both the changes in direction of the Law since 1980 and the contradictory demands of freedom and regulation that must be adjusted in the future.

Apart from the specific licencing and reporting requirements mentioned above, the key to government intervention will lie in the willingness of the courts to impose a tight rein on the remaining areas of discretionary power left to the administration. For example, the criteria governing the designation of protected companies in the Supplementary Provisions are such that the investment might:

- imperil the national security,
- disturb the maintenance of public order,
- prevent the protection of the safety of the general public,
- adversely and seriously affect the performance of Japan's national economy.[22]

The relevant minister is empowered to study these criteria, but it is not specified that the inquiry should be made public, that the foreign parties concerned have a right to make submissions to the minister, or that reasons for a decision are required. Nor does the legislation define the Japanese Diet's understanding of when any of the above conditions may be met. Will the courts give these criteria a broad or narrow reading?

A different set of criteria apply to situations in which the Minister of Finance may deem that a capital transaction can only be executed under a licence, or that a capital transaction should be altered or suspended. The minister may intervene under article 21(2) if a capital transaction:

- might make the maintenance of the equilibrium of the country's balance of international payments difficult,

- might result in a drastic fluctuation of the foreign-exchange rates of Japanese currency, or
- might result in transfers of funds between Japan and foreign countries in a large volume and thereby adversely affect the money or capital market.

What is meant by "difficult", "drastic" or "large volume"? Will the courts or the administrators define these terms? By way of contrast, the approach of the US Congress to defining similar economic circumstances is instructive. The criteria are equally broad, but the limits on administrative actions are very tightly drawn.[23]

Article 23 allows the alteration or suspension of a transaction in those cases where one of the following occurs: the transaction affects the domestic money or capital market or the business activities of specified sectors of the Japanese economy, the transaction impacts on the international money market or derogates from Japan's international reputation, or the transaction affects the performance of international arrangements to which Japan is a party. The article concludes by repeating the principle that transactions that would endanger public order or international peace and security should be controlled.

Section 27(1), which deals with the conditions under which the Ministry of Finance and the minister in charge of a particular industry may intervene in a direct domestic investment transaction, sets out a further list of criteria. The first criterion repeats the national security and public order concern, the second is specifically designed to protect competing Japanese companies, the third limits investments from countries where foreign-investment rules do not provide reciprocal or equal treatment to Japanese investors, and the fourth allows the ministers to deem that direct domestic investments are in reality capital transactions that should be governed by the licencing requirement of article 21(2).

Finally, article 9 allows the competent minister to suspend any transaction subject to the law when he "deems it urgently necessary" in the event of a "drastic change" emerging in "the international economic event situation". The vagueness of this provision should also be compared with its US counterpart.[24] To give content to some of these provisions, a "fundamental policy regarding emergency controls" was published by the Committee on Foreign Exchange and Other Transactions,[25] (established under article 55(2) of the law), which sets out general propositions relating to the application of article 21(2) and article 24(1).[26] No mention is made of the provision of article 9 or of article 2(1) of the Supplementary Provisions. Consequently, there are no legislative definitions to amplify these criteria, and so the ministries are guided only in part by the views of the committee.

It remains to be seen whether these criteria, apart from those governing designated companies, will be employed often. The criteria are so broadly stated that it is possible to argue that the thrust of the program could be changed at any time by a government with sufficient nerve--without the need to resort to any legislative amendment. One leading Western commentator maintains that at least one of the above criteria has applied to every case since 1971.[27] The possibility of an administrative change in direction, coupled with the detailed application of the licencing and approval systems, provides the basis for foreign doubts about the actual "internationalization" of this part of the Japanese economic system. Significantly, there has not been official resort to them to date.

Foreign-Exchange Transactions

The Exchange Rate

The exchange rate between United States and Japan has, in the last two years, become very significant in negotiations between heads of government. Allegations by the United States that the Japanese yen is overvalued by at least 25 per cent are routinely included in discussions concerning the balance of trade between the two countries. Japan, on the other hand, has laid the blame for the yen-dollar value squarely at the door of the monetary policy of the Reagan administration, which has kept interest rates in the United States at a much higher level than those in Japan. Again, the US response has been to criticize the Japanese for their adherence to low interest rates.

The liberalization of the Japanese yen is the key to its increasing use as an international currency. It is estimated that the yen is currently used in less than 2 per cent of world economic transactions.[28] There is no doubt that the major Japanese banks are strong supporters of an increased international role for the yen. However, while they are eager to develop their activities in Europe and the United States, the continuing reluctance to allow foreign banks (including trust banks) to operate freely in Japan suggests that there is still a strong desire to protect the domestic economy.[29] In the light of these discussions, it is very important to be clear on the method by which the exchange rate is fixed in Japan.

The basic provisions of the old system governing the fixing of Japan's foreign-exchange rate have not changed. As before, the Ministry of Finance, with cabinet approval, fixes the rate of exchange and designates which currencies may be used in effecting any transaction authorized under the Law.[30] As we have seen, article 9 gives the government an emergency power to suspend the transactions. Similarly, the old provisions authorizing the activities of foreign-exchange banks have been continued.[31]

Exchange Transactions

The major change, mentioned above, is the elimination of the old Chapter V of the Law, which set out a series of general restrictions and prohibitions on transactions involving foreign exchange, including foreign-investment transactions. The old Law took the form of prohibiting transactions "unless authorized as provided for in this law or in Cabinet orders".[32] The transactions prohibited were described in broad terms such as "any payment to a foreign country" or "claimable assets".[33] The actual content of the rules was set out in Cabinet orders, subsidiary ministerial ordinances, or ministerial designations or notifications. These could be readily amended. The new Law gives legislative content to all transactions covered by the law, while declaring that the transactions shall proceed unrestricted--unless limited by the law.[34]

In fact, a high degree of liberalization had been achieved prior to the amendments to the law in 1980. The process began in 1977 with a series of steps that "liberalized investment and securities, the holding of foreign currencies by residents, purchases of real estate abroad and other personal transactions. Changes in 1978 liberalized settlement methods for import and invisible transactions, outward direct investment and yen convertability."[35] Then in 1979, there was a total decontrol of portfolio investment in Japan by non-residents, excluding investment in "Gensaki" bond transactions, in which the repurchase of the securities was guaranteed. These transactions were permitted for non-residents in May 1979. The following month, Japan's foreign-exchange banks were permitted for the first time to provide short-term "impact" foreign currency loans to Japanese businesses. In March 1980, interest rates on free yen deposits by non-residents were decontrolled and the Japanese foreign-exchange banks were permitted to enter into long- and medium-term "impact loans". With the enforcement of the new foreign-exchange law in December 1980, Japanese residents were finally able to invest in foreign currency deposits. By the end of 1982, the foreign currency holdings of Japanese companies exceeded yen 7 trillion.[36] These developments in the foreign-exchange market were closely linked to the liberalization of domestic monetary policy.

While most inward transfers have been liberalized, the Ministry of Finance is still controlling outward flows of funds from Japan by administrative guidance, rather than legal decree. External transfers have been a concern since 1979.[37] The restrictions were significantly relaxed in 1981 and early in 1982, when yen-based issues on the Japanese market were briefly encouraged. However, controls had to be reimposed in late 1982 in response to a rapid outflow of capital from Japan, which led to a weakening of the yen and strong complaints from overseas about the aggressive competition from the Japanese banks and securities companies in overseas financial markets.[38] A recent report indicates that overseas subsidiaries of these institutions underwrote some 700 issues in the Eurodollar market in 1982.[39]

Recent reports indicate that the Ministry of Finance plans to maintain the controls imposed on external operations of Japanese banks for the first half of fiscal 1983.[40] According to these limits, Japanese banks are able to lend up to yen 600 billion in yen-denominated loans and $9 billion in dollar loans. No bank can lend more than 20 per cent of its net worth in any one country. Sales of yen-based bonds in Japan by foreign interests were limited to about yen 200 billion in the April-June 1983 quarter. In May 1983, the banks and securities companies agreed to formulate rules to evaluate high-risk issues of these foreign bonds in Japan. The Ministry of Finance offered to assist in developing rules to improve Japan's capital market: this record of restraints indicates the flexibility still available to the Ministry of Finance.[41]

Ironically, the liberalization of Japan's foreign-exchange system has not always been beneficial to overseas interests. The market for "impact" foreign currency loans in Japan had been a monopoly of the foreign banks until December 1980. Liberalization has led to strong competition from the Japanese banking system. More important, the relaxation of controls on external transactions has led to aggressive competition from Japan in overseas financial markets, while the volume of capital leaving Japan has weakened the yen, thereby assisting Japanese exporters.[42] Approximately $3 billion left Japan in the June-September quarter of 1982, bringing the total of medium- and long-term off-shore loans by Japanese institutions to $58.4 billion. On the other hand, outflow was cut significantly in October and November 1982, in response to the substantial decline of the interest rates in the United States. The Japanese financial press reacted to these developments with language that echoed the wording of the emergency criteria in the Law. The Ministry of Finance is said to be extremely sensitive to foreign criticisms of Japan's external transactions, but has reacted by persuasion rather than by resorting to the Law itself.[43] Meanwhile, foreign critics of Japan's old system are now realizing the adverse implications of "liberalization".

The steady development of measures to liberalize Japan's foreign-exchange structure reached a new plateau in late May 1984, when the Japanese Finance Minister and the US Treasury Secretary received a report compiled by the Working Group of Joint Japan-US

Ad Hoc Group on the Yen-Dollar Exchange Rate, Financial and Market Issues. The fact that a report was prepared by such a high-level joint working group is a significant indicator of the importance that financial issues has gained in the United States-Japan relationship. The report contains undertakings by the Japanese government that have yet to be implemented in legislation, or in administrative procedures. However, the major features of the report will govern Japan's economic strategy for at least the next two years. The Finance Ministry agreed to allow non-Japanese parties to participate in issues in the Euro-yen markets and stressed that from 1 April 1984 some thirty Japanese firms had become eligible to issue straight Euro-yen bonds and that about one hundred others are now eligible to issue convertible Euro-yen bonds.[44]

The Japanese also agreed to remove restrictions on interest rates within Japan, a major factor in the outflow of funds to markets offering higher interest rates. These interest-rate adjustments are to be phased in over a two-year period, and so the liberalization of the Euro-yen market will proceed much more quickly than the liberalization of the domestic market. It is reported that this will have a major impact on the long-term credit situation in Japan, in particular for the Long-Term Credit Bank.[45]

An Off-shore Market in Tokyo

There has been a long debate about a development which many see as the next stage in the internationalization of Japan's economy.[46] The case for an off-shore financial market or banking centre in Tokyo has been stressed since the early 1970s. A study group led by a former Vice-Minister of Finance investigated off-shore markets around the world in late 1982. The recent establishment of the off-shore market in New York has provided further impetus for requests for a similar market in Japan, which is seen as the logical focus for a financial centre in Asia. The off-shore market debate embodies the concerns that have been addressed in this paper. On the one hand, Japan is clearly the financial dynamist of Asia--the yen has acquired the status of a front-ranking reserve currency, the country has remarkable political stability, and the development of her financial institutions over the past decade fit her to play a leading international role. On the other hand, there is the long-held fear by Japanese bureaucrats that Japan is not as strong as its critics suggest and that no action should be taken that would lead to a loss of control by the Japanese authorities over their economy. The steps taken since 1980 have moved Japan further in the direction of acquiring an off-shore market. It is significant that proposals for a Tokyo market stress that there would be a strict separation between the operations of the market and domestic transactions. The legitimacy of this approach has been strengthened by a similar requirement in the New York market. The only remaining legal barriers are as follows:

- the need to change both the income tax laws providing for withholding tax on interest paid to non-residents[47] and the transaction tax on securities transactions;[48]
- amendments to the interest rate ceilings fixed under the temporary interest-rate adjustment law, which has maintained the Japanese interest rate at less than 10 per cent throughout the whole of the period of high interest rates in other countries;[49]
- relaxation of the limitations on the external transactions described above, where those transactions occur in the off-shore market.[50]

Financial Institutions

The first limb of the pre-1980 economic control structure was a close definition of various types of transactions and a clear division of government authority over those transactions. The second major limb was an equally close definition of the types of institution that could engage in those transactions. This was most evident in the clear distinctions drawn between various types of financial institutions. The primary separation was between the banks and the securities companies. Banks and their activities were supervised by one branch of the Ministry of Finance and securities companies by another. Certain transactions were then placed within the exclusive province of these institutions. Banks were long excluded from transactions involving securities--including government bonds[51]--and were limited to banking business.[52] On the other hand, securities companies had a monopoloy on securities transactions, but were not entitled to engage in the banking business--banks were unable to underwrite corporate securities and were confined to making loans to Japanese enterprises.

The process of reforming Japan's financial markets over the last ten years has led to a breakdown in the division of function between banks and securities companies. Since 1980 in particular, the subsidiaries of both banks and securities companies have been entitled to underwrite issues in the Eurobond Markets, and so in foreign markets the functions of the two types of institutions have merged. A new banking law was promulgated in 1981, which allowed banks to enter the securities business in relation to Japanese government bonds.[53] Japanese banks are now urging that they also should be entitled to underwrite securities in the domestic market, while pointing out that the securities companies have developed financial devices that involve them in holding deposits for their clients.

The banks are divided into specialized categories under the banking law. In the first group, there are 13 city banks, which are at the same time the largest banks in Japan. All of them are authorized foreign-exchange banks and one, the Bank of Tokyo, specializes in foreign-exchange transactions. The second group comprises the regional banks, which are in principle confined to the regions in which they are incorporated, but which in practice have spread their operations throughout Japan. There are 63 regional banks, 58 of which are authorized foreign-exchange banks. In the third category are the long-term credit banks, which have a virtual monopoly on long-term financing. The city banks and regional banks have been limited to short-term financing transactions. The three long-term credit banks are also authorized foreign-exchange banks. A further category comprises the trust banks, which are incorporated under the banking law but concurrently engage in trust business. There are seven of these banks and, again, all are authorized foreign-exchange banks. In addition there are mutual banks, credit associations, and credit co-operatives. Thirty-eight of the mutual banks are authorized foreign-exchange banks. The final important category comprises the foreign banks, 65 of which were operating in Japan in July 1981. These banks are all authorized foreign-exchange banks and are registered under the banking law. They have about 3 per cent of the market for loans in Japan but only 1 per cent of the market for deposits.

Virtually all the banking institutions in Japan are concurrently authorized to engage in international transactions. The changes in the Foreign Exchange and Foreign Trade Control Law affect them all. All of the city banks rank among the 100 largest banks in the world. For this reason, the changes in the Banking Act in 1981, which liberalized the domestic banking structure by allowing banks to sell certain government bonds in over-the-counter sales and to develop new financial instruments such as certificates of deposit, are an important part of the overall liberalization of the economy. The new Banking Law ensures an increased role for foreign banks, which are now entitled to engage in virtually the same lines of business as domestic banks. This is an important step forward, as the prior system restricted them from some areas of the banking business. Since these revisions were contemporaneous with important changes to banking laws in Canada,[54] Canadian banks are in a position to take full advantage of the new situation in Japan, and five Canadian banks are now registered in Japan.

Foreign securities companies have been able to establish branch offices in Japan since the enactment of a special law in 1971.[55] However, until the Tokyo Stock Exchange amended its constitution in 1982, they were unable to obtain membership on an exchange. There are no vacant memberships at present. Only four firms, led by Merrill Lynch in 1972, had established branches in Japan by 1980. Since 1973, foreign firms have been entitled to establish subsidiaries in Japan or even acquire an existing Japanese securities company if they could obtain the consent of the board of that company. There have been no takeovers to date, but speculation has been aroused by the possibility that membership on an exchange may be gained by way of a takeover.

In legal terms, the internationalization of financial institutions has progressed a long way. At least another 50 foreign firms have representative offices in Japan and are now entitled to obtain a licence to underwrite yen-denominated foreign bond issues. On the other hand, Japanese securities firms are expanding aggressively overseas, both in Europe and in the United States. Nomura Securities is now a member of the New York Stock Exchange. Once again, internationalization will be reciprocal.

Foreign Trade

Having discussed extensively elsewhere the role of administrative discretion in Japan's foreign-trade regulation,[56] I will limit myself here to some important policy issues that have arisen over the past few years. The legislative framework for Japan's imports and exports is found in the Foreign Exchange Law and Foreign Trade Control Law,[57] which are the sources of authority for quantitative controls, the Customs Law[58] and the Customs Tariff Law,[59] which fix tariffs and establish principles for countervailing duties and anti-dumping duties,[60] and the Export-Import Trade Law,[61] which allows for the establishment of import and export cartels as a specific exemption to the Anti-Monopoly Law.[62]

Japan argues strongly that her tariffs are no longer an impediment to imports. While specific instances of problems with tariff classifications and valuations will no doubt continue to occur, Japan argues that her average tariff level is well below that of other major industrialized nations. Foreign critics counter that tariffs remain high on items that Japan wishes to protect. Japan is at an advanced stage in the implementation of the Tokyo Round GATT accords and has been rewarded by the assertion that if Japan's economy could so easily adjust to the agreed changes, then it could have agreed to give more away. Whatever the merits of the economic arguments, the response of the legal system to the Tokyo Round has been impressively swift.[63]

The 1980 amendments to the Foreign Exchange and Foreign Trade Law did not affect the previous provisions relating to foreign trade. This law establishes extensive administrative discretion in relation to quantitative export controls (article 27) and quantitative import controls (article 52). The focus of foreign criticisms of Japan's foreign trade during the 1980s concentrated on the limitations imposed by licencing systems established under these provisions. The criticism has been so successful that, with the exception of certain agricultural products, the licencing system has largely disappeared. The focus of criticism of Japan's import structure has now moved to a complex web of domestic laws which are said to operate unfairly in relation to imports. Japan has been responding to these criticisms. The office of the Trade Ombudsman has been established and Japan has identified some 90 instances of legal impediments that it proposes to eliminate. The list in Appendix 2 is an impressive catalogue of non-tariff barriers.

As a counterweight, it is therefore not surprising that Japan is now paying far more attention to long-dormant provisions in its customs tariff legislation that empower the government to impose countervailing duties and anti-dumping duties. The first application by a Japanese industry for the imposition of anti-dumping duties came in December 1982 when the Japan Spinner's Association complained about imports of cotton yarn products from South Korea.[64] At the same time, the association sought the imposition of countervailing duties against Pakistani yarns, based on alleged export subsidies provided by the Pakistani government. These latter proceedings were based on a new cabinet order issued in May 1980, setting up procedures to be followed in countervailing duty enquiries.[65] However, as the US and Canadian experience shows, this type of legislation, based on the principle of restoring equality to the market, offers far less scope to administrators in their limiting of trade volumes.

The history of the framework for regulating Japan's imports over the past ten years has been one of shrinking bureacratic power due to a retreat from the comprehensive controls possible under a licencing system. The residual controls on imports of beef, leather goods, tobacco, and citrus fruits remain major irritants, but are now almost in the position of anomalous controls within the total Japanese legal structure. However, the basic laws that supported the old controls are still in place. The retreat has been administrative, not legal.

In contrast, foreign pressure has produced a reverse effect in relation to Japan's export trade. While the recently negotiated quotas on Japanese motor vehicle exports to Canada may make good political and economic sense within Canada, their effectiveness depends on whether such quotas support the Japanese authorities in that type of extra-legal, discretionary activity that has so long been criticized when applied to Japanese imports. In my view, the voluntary export quota device, however well it is dressed up by economic arguments based on orderly marketing, is contrary to the spirit and letter of existing international legal arrangements and is destructive of the domestic legal process.[66] Restraints, such as those placed on motor vehicle exports to North America, reflect an inability in the legal systems of both Canada and the United States to justify action under their own established legal criteria for import controls. As a result, North American governments have encouraged the Japanese to regulate exports through the Japanese domestic legal system. This involves either the imposition of restraints by government decree with the force of law, which the Japanese government has been reluctant to do, or resorting to extra-legal restraints based on administrative guidance, relying on the reluctance, or the inability, of Japanese interests to bring legal actions to challenge the arrangements. Only one suit has ever been instituted against voluntary restraints, and it was withdrawn.[67] Case law, in the United States at least, suggests that a similar approach would not be acceptable.[68] The dangers inherent in voluntary controls are emphasized by the negotiations that were necessary to ensure that the voluntary export controls on motor vehicles, to be implemented in Japan at the request of the American authorities, would not be a breach of the anti-trust laws of the United States.[69]

Largely as a result of the quotas, profits in the US auto industry in 1983 were $3.4 billion. The immediate reaction of the companies was to award substantial bonuses to its executives, in spite of management's public stance against any significant pay increases to the auto workers. It has been estimated that the import quotas will have cost American consumers $20 billion over the four years in which they operated. The immediate reaction of US's chief trade negotiator, William Brock, was one of anger, and he indicated that he did not believe that the restraint program should continue beyond the current year. In spite of this, the automobile companies in the United States and Canada called for an extension of the quotas. There is obviously a need for a very detailed examination by political scientists and economists of the operation of the automobile quotas. There is much work to be done on the political basis of the quota agreements and their economic impact. Legally, the experience seems to support my basic proposition, that the United States and Canada have been encouraging Japan to continue with a form of economic regulation that is basically against Canadian and US interests insofar as it supports broad Japanese government intervention. On the other hand, the governments in both countries appear to have failed to obtain any acknowledgment by the automobile companies that government assistance in the form of extra legal quotas embodies some form of reciprocal, social responsibility by the companies.

Allied to the legal framework already described, is the history of Japan's structural adjustment to the changing world economy. The most recent step in this process was the enactment of the Specified Industries Structural Improvement Extraordinary Measures Law in April 1983.[70] There is no doubt that Japan, of all the advanced industrial nations, has been the leader in structural adjustment. Although the new law and its predecesor have been subjected to extensive foreign criticism,[71] the fact remains that there are no similar, long-term responses to a structural decline in specific sectors of the economy in Canada or the United States. The tension between foreign trade policies best suited to Eastern Canada's industrial base and to Western Canada's natural resource base need to be confronted. The experience in Japan should provide some basis at least for policy discussions in Canada.

Internationalization or Nationalization?

I would argue that Japan has made significant amendments to the legal framework for foreign trade and investment, amendments which will have long-term benefits. The 1980 amendments to the foreign-investment and foreign-exchange structure are the high point in this change of direction. The legislation not only asserts that freedom of transactions is its fundamental objective, but it gives legislative definition to the transactions to be regulated. The stated criteria that would justify administrative intervention are cast in such a way as to suggest that the need to resort to them will depend heavily on particular circumstances. With the exception of the designation of certain protected companies, the legislation criteria have not been used.

I have also argued that changes in the international financial structure have occurred at the same time as significant developments in Japan's domestic financial arrangements. In particular, the old, rigid barriers between the banks and securities companies, and between banking and securities transactions, are being broken down. The overt legal barriers that work against the activities of foreign financial institutions in Japan are also in the process of being dismantled. While the legal basis is changing, there has been every indication that the Ministry of Finance will want to continue its previous regulatory pattern of reliance on persuasion, rather than legal sanction, in its dealings with financial institutions.

In the foreign trade field, Japan has, in general, been forced to retreat from its primary barricades, based on tariff and quantitative controls, to a fallback position, based on non-tariff barriers. Tremendous pressure is now being applied to dismantle these structures and to force her back to an even more limited line of defense, based on countervailing duties, anti-dumping duties, and the Anti-Monopoly Law. The retreat from the first line of defence was achieved without amending legislation. The administrative apparatus for foreign-trade control was eliminated without the need to amend the laws. The secondary, non-tariff barriers will require amendments to a wide range of laws, however, because the more important restraints are based on the administrative practices that have developed, practices that, in turn, rely on the powers conferred by these laws. The judicial process has played virtually no role in the realignment of the foreign-trade structure in Japan.

Conclusion

The opening of the Japanese market by the end of 1980 has resulted in the unleashing of powerful new forces in the world's financial markets, which matches the already greatly feared presence of Japanese exports of goods. The major task of the international economic system is now to adjust to Japan's presence. Returning to a narrower legal analysis of developments in Japan over the past three years, it is fair to say that Japan has moved away from the pure discretionary framework for the management of its international economic transactions. The process of change since 1978 has been categorized by intense public debate prior to legislative changes, and full debate in the Diet. The legislative product, while lacking the technical precision of US economic laws, compares favourably with comparable legislation in Canada and the United Kingdom. The criteria governing government intervention are now more extensive than criteria in comparable Canadian legislation. On the other hand, there are apparently far fewer formal challenges to decisions within the Japanese administrative process than in the United States or Canada, and court action is virtually non-existent. While the lack of court action is most significant in a comparison with the operation of the United States structure, there is far less significance in a comparison with Canada, where court actions are also rare. The role of court action could be far more important if the administrators in Japan chose to impose their policies in a way that contravenes or circumvents the new legal structure. Canada should be extremely cautious about aligning itself with the US attempts to force this type of approach on the Japanese authorities, as this country is now threatened by the export of both capital and goods from Japan.

Notes

1. *Japan Times*, 28 April 1984, p. 1.
2. "Bush, Brock Stall for Time to Analyse Move--US Wary of Japan's Market-Opening Measures", *Japan Times*, 29 April 1984, p. 1; and "Too Little, Too Late--Wm. Brock", *Japan Times*, 3 May 1984, p. 1.
3. "Takeshita, Regan Presented Bids to Ease Capital Marts", *Japan Times*, 30 May 1984, p. 1; "Regan Says Japanese Easing of Money Marts 'Appropriate' ", *Japan Times*, 31 May 1984, p. 1.
4. Law No. 65 of 1979, effective 1 December 1980, amending Law No. 228 of 1949.
5. Law No. 163 of 1950. The abolition took effect on 1 December 1980.
6. Law No. 59 of 1981 and Law No. 25 of 1984 respectively.
7. For a full analysis of the pre-1980 investment system see Dan. F. Henderson, *Foreign Enterprise in Japan: Laws and Politics* (Chapel Hill: Univ. of North Carolina, 1973) and Zentaro Kitagawa, ed., *Doing Business in Japan* (New York: Matthew Bender, 1982), Volume 6, Chapter 4.
8. Henderson, *Foreign Enterprise in Japan*; A. Kawamura "The History of Japanese Foreign Exchange and Investment Control" in *Law and Business in Japan*, edited by A. Kawamura, pp. 73-94 (Japan-Australian Businessman's Cooperation Committee, 1982).

9. Law No. 65 of 1979; see note 4.
10. This was repeated by Ministry of Finance officials: K. Seki, "The Amendment of the Foreign Exchange and Foreign Trade Control Law and the Effects Thereof" (1981), 2 *Japan Business L.J.* 29; K. Seki, "Foreign Exchange Law" (1980), 1 *The Japanese Business Law Journal* i. For a detailed analysis of the new system, see the Special Issue devoted to the subject in (1981), 2 *Japan Business L.J.*, 1-143.
11. Hereafter "Supplementary Provisions".
12. Law No. 65 of 1979, article 57; see note 4.
13. Mining, *Mining Business Law* (Law No. 289 of 1950, as amended);

banking, Banking Law (Law No. 59 of 1981, as amended); and insurance, Insurance Business Law (Law No. 41 of 1939, as amended).

14. M. Tatsuta "Restrictions on Foreign Investment: Developments in Japanese Law" (1981), 3 J. of Comparative Corp. Law and Securities Reg. 159 and Michiko Ito Crampe and N.E. Benes, "Majority Ownership Strategies for Japan" (1982), 1 U.C.L.A. Pac. Basin Law Journal, 41, at 54-60 both give a detailed analysis of this case.

15. The designated securities companies are:
    - Nomura Securities Co.
    - Nikko Securities Co.
    - Daiwa Securities Co.
    - Shin-Nippon Securities Co.
    - Nippon Kangyo Kakumaru Securities Co.
    - San-yo Securities Co.
    - Wako Securities Co.
    - Okasan Securities Co.
    - Yamatane Securities Co.
    - Osakaya Securities Co.
    - Daiichi Securities Co.
    - Yachiyo Securities Co.
    - Toyo Securities Co.
    - Marusan Securities Co.
    - Koa Securities Co.
    - Nashonaru Securities Co.
    - Koyanagi Securities Co.
    - Toko Securities Co.
    - Meiko Securities Co.
    - Tachibana Securities Co.
    - Nichiei Securities Co.
    - Merrill Lynch International Bank, Inc., Tokyo and Osaka Branches, Vickers, da Costa & Co. Tokyo Branch
    - Bache, Halsey, Stuart, Shields, Japan, Ltd., Tokyo Branch,and

Smith, Barney, Harris, Upham International, Inc., Tokyo Branch.

(From Tatsuta, "Restrictions on Foreign Investment" at 165, note 11.)

16. Japan Economic Journal, 1 May 1984, p. 16.
17. Ibid.
18. Ibid.
19. Japanese Industrial Exhibition 1969 v. The State, Tokyo District Court, 9 July 1969, (Case No. 30 (gyo. u.) of 1969), translated in (1971), 15 Japanese Annual of Int'l L. 172.
20. Article 47: "Export of goods from Japan will be permitted with the minimum restrictions thereon consistent with the purpose of this Law." Article 1: "The purpose of this law is to provide for the control of foreign exchange, foreign trade, and other foreign transactions. . .for the sake of the rehabilitation and the expansion of the national economy."
21. See Ibid. and Appendix 1 for the text of these articles.
22. Supplementary Provisions, article 2(1) and 2(2), Appendix 1.
23. Trade Act of 1974 P.L. 93-618, 88, Stat. 1978, s. 122 in 19 U.S.C.S. 2132.
24. Ibid.
25. Established under article 55-2 of the new Law; see Law No. 65 of 1979 (note 4).
26. Translated by Marcia Goodman in (1981), 2 Japan Bus. L. J. 143.
27. Andreas R. Prindle, "Japan is liberalizing the wrong things", Euromoney (March 1980), 96-102 at 96.
28. K. Moritsugu, "Service Sector: Another US-Japan Wrangle?" Japan Times, 26 May 1984, p. 14.
29. "Japan Not Planning Major Measures to Liberalize its Markets: Maekawa", Japan Times, 28 April 1984, p. 6.
30. Law No. 65 of 1979, article 7; see note 4.
31. Ibid., Chapter II, articles 10-15.
32. See article 27 in the prior law (Law no. 228 of 1949, as amended).
33. Ibid.

34. Article 1 and Chapter IV.
35. Prindle, "Japan is liberalizing", at 96.
36. This description is based on a Table in "Changes abroad provide lesson to Japan", The Japan Economic Journal: Second Section "Financial Survey of Japan", 12 October 1982, 24-41, at 24-25. See also "More companies move to manage their funds in foreign currency", The Japan Economic Journal, 3 May 1983, p. 2. Seven trillion yen is approximately $35 billion Canadian.
37. Prindle, "Japan is liberalizing", at 96.
38. "Restraint on yen financing overseas will be continued", The Japan Economic Journal, 29 March 1983, p. 1; "Foreign exchange banks will be able more readily to make lendings overseas; MOF will relax rules", The Japan Economic Journal, 20 October 1981, p. 1.
39. "Eurobond Underwriting by Japanese banks' overseas subsidiaries grows fast", The Japan Economic Journal, 3 May 1983, p. 1.
40. See note 38.
41. "Rule is slated for yen-based private bond issuance", The Japan Economic Journal, 10 May 1983, p. 1. The restraints are now subject to the agreement concluded with the United States in May 1984; see note 3.
42. The development has added fuel to protectionist movements in the United States; see "A tough choice on yen controls", Business Week, 8 November 1982, p. 99.
43. Ibid.
44. "Takeshita, Regan Presented Bids to East Capital Markets", Japan Times, 30 May 1984, p. 1.
45. "Bankers Welcome Yen-Dollar Report", Japan Times, 31 May 1984, p. 5.
46. W.F. Monroe, "The Rise of Tokyo as an International Financial Centre", (1974), 8 J.W.T.L. 655, Prindle, "Japan is liberalizing"; and B. MacNaughton, "Comment: Japan's Trade and Currency Regulations: Do the Changes put Japan in the Mainstream of World Commerce or Are They Merely an Illusion?" (1981), 16 Tex. Int'l. L. J. 245, at 257-8.

47. *The Special Taxation Measures Law* (Law No. 26 of 1957, as amended) provides for a special withholding tax at source on the interest from securities. The rates in 1980 varied from 16 to 35 per cent, depending on the security involved. Japan Securities Research Institute, *Securities Market in Japan 1980* (Tokyo: Japan Securities Research Institute, 1980), 183.
48. Japan Securities Research Institute, *Securities Market in Japan 1980*, 192-3. The rate was between 0.0001 per cent and 0.0045 per cent, depending on the transaction, as of December 1980.
49. *Rinji Kinri Choseiho* (Law No. 181 of 1947, as amended), article 2.
50. Securities and Exchange Law (Law No. 25 of 1948, as amended) article 65. M. Shimojo, "The New Banking Law of Japan: Securities Business by Banks" (1982), 11 *U.C.L.A Pac. Business L. J.* 83, describes the system and the changes in 1982 in great detail.
51. *The Law Concerning Implementation of Amendments to the Commercial Code* (Law No. 73 of 1978) conferred a monopoly over certain bond and trust business on banks and trust companies. Shimojo, "New Banking Law of Japan" at 88-90.
52. Law No. 59 of 1981. Shimojo, "New Banking Law of Japan" at 90-3, and 102-7.
53. This discussion is based on Shimojo, "New Banking Law of Japan" at 85-90, and "Financial Survey of Japan", *The Japan Economic Journal*, 12 October 1982, p. 41.
54. *Banks and Banking Law Revision Act*, S.C. 1980 Ch. 40 s.2. Proclaimed in force 1 December 1980.
55. Foreign Securities Firm Law (*Gaikoku shoken gyosha ni kansuru horitsu*), (Law No. 5 of 1971, as amended).
56. M.D.H. Smith, "Administrative Discretion in Foreign Trade Regulation: United States, Australia and Japan", S.J.D. Dissertation, Harvard Law School, 1976 (unpublished); and M.D.H. Smith, "Administrative Discretion in Foreign Trade Control: The Regulatory Paterns in Australia, Japan and the United States--Part I" (1974), 2 *Australian Bus. L. Rev.* 180.

57. Law No. 65 of 1979; see note 4.

58. Kanzei ho (Law No. 61 of 1955, as amended).

59. Kanzei Teiritsu ho (Law No. 54 of 1910, as amended).

60. Ibid., article 8 (Countervailing Duties) and article 9 (Anti-Dumping Duties).

61. Yushutsu nyu torihiki ho (Law. No. 299 of 1952, as amended).

62. Law No. 54 of 1947.

63. J. Jackson et al., "Implementation of the Tokyo Round: Legal Aspects of Changing Economic Rules" (1982), 81 Michigan L. R. 261, at 341.

64. "Spinners ass'n takes action against ROK, Pakistan yarns", The Japan Economic Journal, 11 January 1983, p. 1.

65. For a translation see R. Seeman (editor and translator), The Japan Law Letter, December 1982, p. 15.

66. M.D.H. Smith, "Voluntary Export Quotas and U.S. Trade Policy--A New Non-Tariff Barrier" (1973), 5 L. and Pol. in Int'l Bus. 10.

67. This was an action by Japan's textile unions against the 1971 textile restraints negotiated with the United States.

68. Consumer Union of U.S. v. Rogers et al. (1972), 12 Int'l Legal Materials 190, (U.S. D.C. for D.C.). The case concerned steel exports to the U.S. Note that s. 607 of the Trade Act 1974 (see note 23) specifically shielded the participants in the steel export control arrangements from further legal actions.

69. See correspondence between the Japanese Ambassador to the United States and the Attorney-General of the United States, quoted in M. Matsushita and L. Repeta, "Restricting the Supply of Japanese Automobiles: Sovereign Compulsion or Sovereign Collusion?" (1982), 14 C. W. Reserve J. Int'l L. 47, at 78-81.

70. Law No. of 1983. R. Seeman (ed.), The Japan Law Letter, March 1983, 12-20.

71. For example, U.S. Trade Representative W. Brock's comments quoted in "Foreign criticism and Japanese rebuttal", The Japan Economic Journal, 22 February 1983, p. 5. For a discussion of Japanese industry's response to the proposed law, see "Industries

are not convinced whether it will become a panacea" at p. 4 of the same issue.

Appendices

Appendix I

Objective

Article 1 The objective of this Law shall be, on the basis of the freedom of foreign exchange, foreign trade, and other external transactions, with necessary but minimum control or adjustment, to enable proper expansion of our external transactions, and thereby to facilitate the equilibrium of our balance of international payments and the stability of our currency, as well as to contribute towards the sound development of our national economy.

Suspension of Transactions in Case of Emergency

Article 9 When a drastic change emerges in the international economic situation, and the competent Minister deems it urgently necessary, he may suspend any transaction governed by this Law, as a Cabinet Order provides for, within a period designated by the Cabinet Order.

Article 21

1. It might make the maintenance of the equilibrium of our country's balance of international payments difficult;
2. It might result in a drastic fluctuation of our currency's foreign exchange rates; or
3. It might result in transfers of funds between Japan and foreign countries in a large volume, and thereby adversely affect our money or capital market.

Article 23

1. It might adversely affect the international money market or derogate from the international reputation of our country;
2. It might adversely affect our money or capital market;

3. It might adversely affect the business activities of a certain sector of our industries or the smooth performance of our national economy; or
4. It might disturb the faithful performance of treaties or other international agreements concluded by our country, or imperil the international peace and security, or disturb the maintenance of public order.

Article 27

1. It might imperil the national security, disturb the maintenance of public order, or hamper the protection of the safety of the general public;
2. It might adversely and seriously affect activities of our business enterprises engaging in a line of business similar or related to the one to which the direct domestic investment, etc., is to be made, or the smooth performance of our national economy;
3. Because it is made by a foreign investor with whose country no treaties or other international agreements are concluded by our country in regard to the direct domestic investments, etc., its particulars are required to be altered, or its execution is required to be suspended, so as to make conditions substantially equal to those allowed to our national's direct investment activities (which mean those tantamount to direct domestic investment, etc., mentioned in each Item of Paragraph 2 of the preceding Article) in that country; or
4. When seen from its purpose of the use of funds and others, it falls under, in whole or in part, the capital transactions upon which an obligation to obtain a license is imposed under the provisions of Article 21, Paragraph 2, and therefore its particulars are required to be altered, or its execution is required to be suspended.

Supplementary Provisions

Article 2

1. It might imperil the national security, disturb the maintenance

of public order, or hamper the protection of the safety of the general public; or

2. It might adversely and seriously affect the smooth performance of our national economy.

Appendix II

	Items	Classification	Details of Measures
1.	Adoption of a "After Permit Examination" System	A	In order to further facilitate cargo clearance procedures, a new system is to be introduced as an important exception to the general rule which requires all the necessary procedures to be completed before the issuance of import permit. Under the new system, imported cargo may be released from customs immediately after the completion of the check relating to the requirements under "other laws" and rules of origin. Accordingly, the examination for official duty assessment, is to a large extent, deferred until after the cargo is cleared.
2.	Simplification of Examination Procedures	A	A new system is to be adopted to streamline the examination procedures. Under the new system, goods routinely imported may be relieved from customs examination. For this purpose, an importer may apply for the approval of "simplified examination" at the time of the first importation. For subsequent importation, customs examination is virtually obviated upon presentation of the approval.
3.	Minimization of Documentation Requirements	A	Documentation requirements for customs clearance are to be reviewed with a view to minimizing them. Necessary measures will be taken. In particular, to establish rules for requirements so that importers or customs brokers may be relieved from the burden of excessive documentation.
4.	More Selectivity in Physical Inspection	A	A new administrative policy is to be adopted so that physical inspection for customs purposes

Items	Classification	Details of Measures
		may be performed on a more selective basis. As a general rule, physical inspection may be obviated on goods identical to those formerly imported and inspected or on goods that can fully be identified by means of accompanying documents.
5. Ensuring Uniformity of Classification	A	A classification center is to be established at Tokyo Customs. Its principal role is to ensure the uniformity of classification by giving adequate instructions to other customs offices or otherwise. It is also expected to function as a nation-wide clearing house for information on classification. An effort is also to be made at each customs office to collect information from the private sector so that lack of uniformity may be found and eliminated.
Liquor Tax Law		
6. Acceptance of Ranking and grading examinations for U.S. made "sake"	A	The grading authorization for "sake" produced in other countries is not rejected under the Liquor Tax Law. If the various kinds of requirements, required for the procedures for receiving grading authorization (such as that the fact that the delivery and receipt of the "sake", complete with the containers from which the samples were taken, have been duly recorded and registered, etc., has been confirmed by the appropriate authorities concerned of the other country, etc.), are properly met. It can receive authorization.
Ministry of Education		
7. Acceptance of foreign products under the official approval system for sports goods of sports organizations	A	Guidance had been given to various sports organizations which adopt official approval system for sports goods, to accept foreign made sports goods. As regards tennis balls and metal baseball bats over which there were problems, the

Items	Classification	Details of Measures
		sports organizations concerned have taken measures for accepting foreign products.
Ministry of Health and Welfare (Pharmaceutical Affairs Law)		
8. Acceptance of animal tests data generated abroad in respect of medicine and cosmetics	A	Study is currently under way on the implementation of Good Laboratory Practice (GLP) standards for the conduct of safety tests on pharmaceuticals. It is expected that measures will be taken, together with this implementation to accept foreign generated test data. The same measures will be applied to cosmetics (modification).
9. Acceptance of clinical test data generated abroad in respect of medicines and medical instruments: Partial acceptance of animal experiment data generated abroad	A	Animal test data, Clinical test data, Phase 1 clinical test data on overseas Japanese; Pharmaceuticals, A (notification), D, (A); Medical Instruments, A (notification), D.
10. In regard to pharmaceuticals, the acceptance of data on tests conducted by foreign countries. In regard to acute and sub-acute toxicity tests and Phase 1 clinical tests with Japanese persons living in Europe as the objects. Introduction of accelerated tests in regard to stability tests. Clarification of standards for chronic toxicity	A	As for data concerning acute and sub-acute toxicity tests, they will be accepted at the time of the implementation of GLP (A) (notification). Data on Phase 1 clinical tests with Japanese persons living abroad as the objects will be accepted (A). The introduction of accelerated tests to take the place of tests for long-term stability tests, is not acceptable, as there are many unknown factors, such as active ingredients, in regard to new drugs (D). Measures are planned to be taken for the clarification of the standards for chronic toxicity tests (A) (notification).

	Items	Classification	Details of Measures
11.	Acceptance of data on cosmetics generated abroad in areas other than safety test	A	Data on tests conducted by other countries are already being accepted Explanatory note A Items that are to be improved. Measures for improvement already undertaken, (in whole or in part). Measures for improvement to be undertaken (in whole or in part). Measures expected to be undertaken if appropriate results are obtained from further studies. B Items that are to be studied further. C Items based upon misunderstanding. Complaints without any ground. Japanese standards already meeting international standards etc. D Items that are to remain unchanged.
12.	Acceptance of data on electrical safety tests which is conducted by foreign manufacturers comparable to domestic manufacturers	B	Although it is a misunderstanding that in the case of domestic manufacturers, data prepared by themselves are sufficient, studies will be made on this complaint in consideration of the handling of electrical appliances in general.
13.	Additional establishment of Japanese Standards of Cosmetic Ingredients	A	In regard to those which are frequently used, efforts will be made for standardization, within three years, as the goal (announcement).
14.	Flexible handling of minor discrepancies between invoices and licences	A	Senior Pharmaceutical Affairs Inspectors located at various ports will be notified in writing (notification).
15.	Simplification of the registration procedures for cosmetics in case of changes in namings and packagings, and minor formula changes	A	In regard to very small formula changes to adjust the color-tone, viscosity, etc., measures will be taken in the direction of omitting the procedures for approval for the changes (notification).

	Items	Classification	Details of Measures
16.	Expediting approval procedures of cosmetic products	A	Efforts will be made to simplify the procedures and to shorten the length of time.
17.	Exemption of requirement, in permitting import licence of drugs, cosmetics or medical devices, to submit health certificates of company executives other than those directly in charge	A	Measures will be taken so that, in the case of juridical persons, the presenting of medical certificates for company executives, other than those who are in direct charge, will become unnecessary (notification).
18.	Widening of opportunities for exhibiting medical equipments prior to approval	A	In regard to ME and related instruments and equipment, which have not yet been approved, measures will be taken to widen the field for exhibiting them, to occasions other than for use in announcing research results at academic meetings.
19.	Introduction of special exception systems for imports of sample drugs for use for pharmaceutical packaging machines	A	Efforts will be made to simplify import procedures (notification).
20.	Relaxation of import regulations on the importation of medical substance samples for testing purposes	D	Although it is impossible to abolish such procedures as quantitative inspection and others, efforts will be made for flexible implementation regarding import quantities.
21.	Transfer of approvals for manufacture and imports among enterprises	D	As manufacturing or import license is granted exclusively to the person of each applicant, and its transfer to others is not permissible.
22.	Prompt import approval of "globulin for intravenous injection" of Merleux Institute	A	Approval is expected to be issued after a decision is reached by the Central Pharmaceutical Affairs Council (specific item).

	Items	Classification	Details of Measures
23.	Outlook for completion of reevaluation of "human placental albumin"	A	It is expected that a decision will be made by the Central Pharmaceutical Affairs Council around the summer of this year, and measures will be taken based on this (specific item).
24.	Prompt import approval of cosmetics containing preservative "Germall-115"	A	The Central Pharmaceutical Affairs Council will reopen its deliberations as soon as the data are submitted (specific item).
25.	Revision of JIS for diagnostic audiometers to meet the international standards, expediting deliberations of its revision and participation of foreign manufacturers in the deliberations and its announcement	A	The JIS will be revised in the near future and it will be made to conform to international standards. As regards participation and public announcement concerning JIS deliberations, measures have already been taken through public announcements and hearing of views in advance etc. (specific item).
26.	Speeding up of approval (6 months) for new-model hearing aids, abolition of testing in case of model changes which do not affect performance: approval of custom clearance and sales of cargo for sales use prior to the reexportation of the products originally imported for testing purposes	A	Approval is currently given in approximately two months for JIS-qualified items. As regards very minor model changes, which do not affect the performance, data are not required. Regardless of whether the cargo for test use has been reexported or not, customs clearance and sales of cargo for sales use are approved (specific item).
27.	Prompt import approval of Beckman Corporation manufactured apparatus for measuring protein "Electrolyte II" and immunochemistry analysis apparatus "ICS" and reagent of "ICS", acceptance of clinical test data processed in the U.S.	A	Foreign clinical test data on reagent "ICS" are treated in the same way as other pharmaceuticals.

Items	Classification	Details of Measures
28. Approval of inoculators which are used in the U.S. and by other international organizations	A	Non-application for imports has been submitted, up until now, but there are actual records of having approved the imports of similar types of goods in the past, and therefore, it is thought that if there is an application, it will be approved (specific item).
Poisonous and Deliterious Substance Control Law		
29. Flexible handling of minor discrepancies between invoices and registration documents	A	Senior Pharmaceutical Affairs Inspectors at various ports will be notified in writing (notification).
Food Sanitation Law		
30. Harmonization with the U.S.A. and Europe in respect of designation and use standards of food additives (Sorbic Acid, etc.)	B	Consideration will be made to take steps for internationalization of these standards on case by case basis, based on the comprehensive study on total human intake, etc., for each specific case. As regards sorbic acid, study will be made as soon as adequate data are available (ministerial ordinance and announcement).
31. Harmonization with the U.S.A. in respect of the limitations on residual SO_2 for frozen shelled prawn	C	The tolerated residual values of Japan are in accordance with the international standards recomended by FAO/WHO.
32. Permitting the use of Sodium benzoate, Grucelle Abiectic Acid Ester and Brominated vegetable oil for soft drinks	B	On Sodium benzoate, studies will be made as soon as adequate data are available in order to reach conclusion. On abietic acid glycerin ester, study will be conducted as soon as data are available. On brominated vegetable oil, it cannot be approved in the light of doubts concerning its safety (FAO/WHO also express the same view on this point) (ministerial ordinance and announcement).

	Items	Classification	Details of Measures
33.	Exemption of heat-pasteurization for mineral water	A	The standards will be revised, with February, 1982, as the target date, so that other methods, which have the same effects as sterilization by heating, will also be approved (announcement).
34.	Acceptance of formula analysis tables presented by exporters	A	If there are analysis charts of inspection organs, etc., which are officially recognized by the Governments of the exporting countries, tests will not be conducted, in principle (notification).
35.	Acceptance of formula analysis tables prepared by the government agencies of the exporting countries in respect of food additives on wine and champagne (SO_2, sallellic acid, sorbic acid)	A	
36.	Clarifying analytical requirements for cargo	A	Efforts will be made to issue instructions thorough goingly so that unnecessary inspections will be eliminated (notification).
37.	Clarifying slaughter-house labeling standards for dried beef	C	It is not required to indicate the name of the slaughter-house since dried beef (beef jerky) is a processed product.
38.	Clarifying the standards for the use of fluorescent dye for tea bags' tags	C	Since tags do not directly touch food, it is not subject to inspection.
39.	Clarifying the standards for the use of fluorescent dye for wrappings of chocolates	C	While import will be approved so long as they do not elute, they will be uniformly created as violating the law in case of elution.

Items	Classification	Details of Measures
40. Exemption of analysis in respect of continuously imported foods, food additives, etc. of the same kind	A	For the continuing imports of cargo, which are considered to have generally the same components, contents, etc., in view of its manufacturing process, etc., only examination on paper will be required, in principle (notification).
41. Presentation of required import declaration for machine parts which do not directly touch food	C	It is not required to report machinery parts which do not come into direct contact with foodstuffs.
42. Exemption of labeling requirements for intermediate raw-materials for processing	C	Labeling is indispensable in order to provide information to users, etc.
43. Shortening of the examination period of residual density for EDB (Ethylene dibromide)	A	Measures were taken for the simplification of inspection, in December, 1981 (measures already taken in the field of operation).
44. Clarifying standardizing process and contents of standards for dairy products, juice, etc.	A	The translating of the standards, etc., into English was carried out. Following this, the revising of the English-language version of the official documents on food additives will be carried out, and information will be supplied to the embassies in Tokyo, industrial organizations, etc.
(Food Sanitation Law) (Law concerning Standardization and Proper Labeling of Agricultural and Foresty Products)		
45. Unification of labeling for the same kinds of goods	A	The laws and ordinances concerned are not requiring over- lapping labeling. Still further, measures will be taken for the thorough spreading of understanding, such as to have the Food Sanitation Inspectors' Office, Ministry of Health and Welfare keep leaflets

Items	Classification	Details of Measures
		for quality labeling standards (JAS) on hand, and to have them offer them to import-related enterprisers.
(Water Works Law)		
46. Adoption of U.S. method for water quality Inspection (AMCO, AEPA-I)	B	If data are presented by the U.S. side, technical studies will be conducted immediately, in accordance with Japan's inspection system (internal rules).
Ministry of Agriculture, Forestry and Fisheries (Domestic Animal Infectious Disease Control Law)		
47. Import Quarantine for for Belgium-produced processed meat	A	Belgium is now being asked to present data, and after studying the presented data, an expert will be dispatched to Belgium, and final conclusion is slated to be reached (ministerial ordinance).
48. Import Quarantine for Argentina-produced beef	D	Foot-and-mouth disease have occurred in Argentina, and the ban on imports cannot be lifted. However, beef, which has been given heat treatment, in accordance with fixed standards at designated plants, has been exempted from the import ban.
49. Import quarantine for processed meat, produced by Yugoslavia, Romania and Austria	A	The zoo-sanitary situations in the three countries were checked, and in November, 1981, the ban was lifted or eased (ministerial ordinance) (measures already taken).
50. Expansion and improvement of inspection facilities of live cattle	A	The accommodation capacity of the existing quarantine inspection facilities is generally sufficient as a whole. Concentration at some inspection facilities is being avoided by the utilization of the prior notification system (measures already taken).

Items	Classification	Details of Measures
(Law Concerning Standardization and Proper Labeling of Agriculture and Forestry Products)		
51. Slight disorders concerning impressed stamping of date of manufacture of canned goods	A	Instructions will be issued, in writing, to the Agricultural and Forestry Products Inspection Institute, etc., during fiscal 1981.
52. Indication of the number of pieces for canned fleshy fruit	B	Further studies will be undertaken, with due consideration to the protection of consumers.
53. Revision of standards for plywood	A	As regards white speck, matters are still at the stage of making tests, but in regards to parts on which tests have been completed, such as adhesive strength and knots, a revision plan concerning concrete standards will be formulated at the earliest possible date, through consultations with the plywood industry and other persons concerned, within the country, and will be shown to the countries concerned. If the understanding of the countries can be obtained, a revision of the standards will be carried out, by taking due procedures (announcement).
54. Revision of JAS, pertaining to Radiata pine lumber	A	As regards to JAS standards concerning average width of the annual growth rings, on which there were requests for revision from New Zealand and Chile, the JAS standards were revised in December, 1981, in compliance with these requests (announcement) (measures already taken).
(Agricultural Mechanization Promotion Law)		
55. Shortening the inspection period of agricultural tractors	A	The inspection period, which had been more than one year, has recently been shortened to half a year (measures already taken).

Items	Classification	Details of Measurcs
(Agricultural Chemicals Regulation Law)		
56. Clarification of the handling of new registration of agricultural chemicals	A	It has been decided that the same handling, as in the past, will be followed even from 1981 and after including agricultural chemicals on which toxicity tests have been started to be carried out since after 1978, the persons concerned have been informed of this decision (measures already taken).
57. Early Introduction of GLP system for toxicity test	C	There is no country which is adopting the GLP system for agricultural chemicals.
(Plant Quarantine Law)		
58. Import quarantine of fresh Australian oranges	A	The U.S. Environmental Protection Agency is now proposing the restricting of the use of EDB (fumigant for oranges). Therefore, for the time being, the development of U.S. restrictions will be watched until around this spring, when it is expected to reach a conclusion, and after that, measures for the lifting of the import ban will be pushed (ministerial ordinance).
59. Simplification of the procedures for the lifting of import bans on fresh fruit produced in Taiwan, such as melons, etc.	D	The procedures for the lifting on import bans are of the minimum necessary requirement, and their simplification is difficult.
60. Import quarantine for fresh fruit from the Philippines, Argentine, Turkey and Chile	D	In the countries coming under this, harmful insects have not been completely eliminated, and perfect disinfection methods have not been established. Therefore, it has not yet reached a stage where the lifting of the ban on imports can be studied.

Items	Classification	Details of Measures
61. Dispatch of experts concerning state of quarantine in the exporter nations (EC)	A	Experts will be dispatched for inspecting the state of the improvement of export quarantine methods, etc., on the part of the exporter nations (EC). (In this case, the EC side's presenting concrete data concerned will be necessary).
62. Increasing of the number of plant quarantine inspectors to be dispatched by Japan to the U.S. concerning U.S. cherries and papaya	B	Further studies will be made, taking into consideration the number of personnel, the balance with other nations to which they will be dispatched, and the state of improvement at inspection stations in the U.S.
63. Abolition of inspection for processed cereal such as wheat flour, etc.	D	In processing, up to the stage of wheat flour, there are cases where insect pests for agricultural products can exist. Therefore, inspection is necessary.
(Law for Improvement and Increased Production of Livestock)		
64. Liberalization of the Use of Imported Bull Semen	D	Livestock semen is a delicate and very fine microscopic living organ, which causes fatal and long-lasted effects on the improvement of livestock, and special consideration is needed for the purpose of using semen of fine and desirable quality in a systematic way, in accordance with the aimed direction of livestock improvement. Even in other countries, such as France and Switzerland, various types of restrictions are imposed. As for imports and use for scientific research purposes, which are approved, even at present, efforts will be made to make this fact more widely known and understood.

Items	Classification	Details of Measures
Ministry of International Trade and Industry (Household Goods Labeling Law)		
65. Permission of labeling in languages other than Japanese	B	Whether admitting of quality labeling textile goods in foreign languages will be appropriate or not, from the standpoint of the protection of consumers, will be further investigated and studied (ministerial ordinance and announcement).
(Consumer Products Safety Law)		
66. Easing of Standards for sports goods	A	The safety standards for metal bats, on which there were requests, have been revised (ministerial ordinance) (measures already taken).
(High Pressure Gas Control Law)		
67. Acceptance of International standards on the wall thickness, etc. of sprays for cosmetics use and for aerosol use	A	Although there are no international standards, the standard for thickness will be made the same as the U.S. standard, as soon as safety is confirmed (ministerial ordinance).
68. Speeding up of checks for accumulators, for machines of the same specifications	C	No import inspection is conducted
69. Acceptance of the results of inspections by Standards Association of Australia (SAA) as to aluminum gas cylinder	A	There are also problems in regard to the Australian side's import inspection procedures for high-pressure gas containers (double inspections). Therefore, standing on the basis of Japan-Australia negotiations, in the future, inspectors will be dispatched (ministerial ordinance).

	Items	Classification	Details of Measures
70.	Acceptance of data of ASME (American Society of Mechanical Engineers), UL (Underwriter's Laboratories), etc. as to pressure resistance tests, etc. of high pressure containers (air-conditioning facilities)	C	No import inspections are being carried out.
71.	Flexible operation of applications by each importer for the same cargo	C	Even if the applications are unified into one, pressure-resistance tests, for example, are conducted for all the products individually, in the same way as in other countries. Therefore, even if a package application is made, it would be meaningless.
72.	Full acceptance of data by the U.S. testing organizations as to pressure resistance tests, etc.	A	The U.S. side does not accept our country's data, in any way at all. However, our country is accepting the U.S. side's destruction inspection data, and in regard to pressure-resistance tests, etc., too, inspectors will be dispatched, based on Japan-U.S. negotiations, in the future, and measures will be taken for the elimination of double inspections (ministerial ordinance).
	(Law Concerning the Examination and Regulation of Manufacture, etc., of Chemical Substances)		
73.	Expansion of the scope of chemical substances listed in Existing Chemical Substances, relaxation of standards for the examination of new chemical substances, and shortening of testing period.	C	The examination procedures, etc., which are now adopted, are indispensable for the protection of man and environment, and they are similar to those of other countries. Also, the test guidelines applied in Japan are similar to the OECD TG, which is internationally recommended.

Items	Classification	Details of Measures
74. Elimination of overlapping applications for the same substances under the above law and the Industrial Safety and Health Law	C	The purports, objectives and the standpoints of examination differ under the two laws, and for this reason, different kinds of data are submitted. Therefore, they are not overlapping application.
75. Expansion of the ceiling amount of new chemicals imports given small-amount handling	C	It is difficult to ease the limit, from the standpoint of the maintenance of the people's health and safety, and various other countries are also enforcing generally similar restrictions.
76. Mutual acceptance of data based upon the OECD Test Guidelines and Good Laboratory Practice	A	Overseas test data generated abroad are already being accepted (operation measures already taken).
77. Application of GLP	A	Measures will be taken, according to the conclusion to be reached by the OECD with respect to the implementation of the GLP compliance scheme.
(Weights and Measures Law)		
78. Acceptance of dual labeling of packaged goods based on the metric system and the yard-pound system	A	Dual labeling of packaged goods has been accepted since 1978 (measures already taken).
(Bicycle Racing Law)		
79. Removal of difficulties in respect of imports of bicycles for race use from the EC	C	There has been no application for registration to the Japan Bicycle Promotion Association (Keirin Association). If the requirements are met, it is possible to register foreign-made bicycles in the case of bicycles for bicycle race use.
(Electrical Appliance and Material Control Law)		
80. Promotion of the unification of the Japanese technical standards with international standards (electric cord)	A	From fiscal 1981, it has been studied systematically. This will be further promoted, and measures will be taken, one by one, based on the results of these studies (ministerial ordinance).

Items	Classification	Details of Measures
81. Simplification of application procedures for authorization of homologation	A	They have already been simplified even when compared with other nations (ministerial ordinance) (measures already taken).
82. Unification of standards for insulation resistance and heat generation of refrigerating equipments with international standards	A	Studies have been carried out systematically, from fiscal 1981. This will be further promoted and measures will be taken, one by one, based on the results of these studies (ministerial ordinance).
83. Approval of Korean agencies as substitute testing institutions of electrical appliances	A	In order to consolidate a system for the promotion of mutual utilization of test data, based on contracts between our country's test organs and overseas test organs, necessary measures are slated to be completed by the end of March 1982. This problem will be handled on the basis of this system (notification).
84. Relaxation of the safety standards for electrical appliances	A	Studies have been conducted systematically from fiscal 1981. This will be promoted, and measures will be taken, one by one, based on these studies (ministerial ordinance).
(Industrial Standardization Law)		
85. Formulation of JIS standards for water faucets made of brass	B	As no data have been submitted by the EC, research is now being made on the Japanese side, and a judgement is slated to be made based on the results of experiments which will be obtained around the end of March 1982.
86. Promotion of the unification of JIS and international standards	A	In order to secure co-ordination with international standards (ISO, IEC), improvement will be promoted in the future too, as has been made in the past.

Items	Classification	Details of Measures
(Ministry of Transport) (Road Vehicles Act)		
87. Dispatch of Inspectors overseas	A	Inspectors are already being dispatched to automobile manufacturers in the U.S. and Europe to conduct examination (measures already taken). In addition in compliance with requests, efforts will be made to expand the objects of their dispatch (operation).
88. Acceptance of the test results conducted by official test organs of other countries	A	The test results on automobiles of the official test organs of other countries are already being accepted, in the case of European nations (measures already taken). In addition, efforts will be made to broaden the scope of the utilization of this measure, including the additional designation of official test organs, etc. (operation).
89. Acceptance of foreign test data on automobiles	A	The results of tests, carried out on the basis of the standards of other countries which are almost the same as the standards of our country, are already accepted (measures already taken). In addition, in compliance with the requests, efforts will be made to broaden the objects (operation).
90. Translation of laws and ordinances pertaining to examination and inspections into English	A	English-language versions of laws and ordinances, etc., concerning examination and inspection of automobiles, have already been complied, and they are being revised, one by one (measures already taken).
91. Shortening of examination period	A	For all models of imported automobiles, the length of time for examinations for type notification has already been shortened to about two months (measures already taken).

	Items	Classification	Details of Measures
92.	Postponement of application of new regulations	A	In the implementation of new regulations on automobiles, their applications are postponed for a certain period of time (measures already taken).
93.	Raising of the number of automobiles to be made the objects for exhaust gas mean value restrictions	A	The automobile models, whose import figure is less than a certain number, are exempted from the exhaust emission mean value standards. The limit number for the exemption has already been raised (measures already taken).
94.	Simplification of approval procedure for type designation	A	Efforts will be made to simplify procedures of examination for type designation such as the reducing of some parts of the examination data, etc., during 1982 (including measures already taken) (operation).
95.	Comparable treatment of the Japan Automobile Importer's Association members to that of "parallel" (without sole-agent contracts) importers.	A	The simplified method of inspection, in respect of exhaust emission tests, will also be approved for the Japan Automobile Importers' Association members in case of a small-number imports.
96.	Adoption of Manufacturers' self-certification system concerning safety and noise regulations: Omission of individual inspection at local Land Transport Offices	D	They are matters which concern the very roots of the system for the ensuring of the safety of automobiles and for the prevention of public nuisances. For this reason it is necessary to maintain the system now in force. However, standing on the purport of U.S. requests (the lowering of the costs for examination and inspections, etc.), necessary measures will be considered in regard to the "reducing of items of test data required to be submitted", "speeding up of the process, through the utilization of prior examination of documents, in addition to the dispatching of inspectors", and "on the proposal" for the utilization of the results of

Items	Classification	Details of Measures
		tests conducted by U.S. Government testing institutes in accordance with Japanese test procedures.
Ministry of Posts and Telecommunications (Public Telecommunications Law)		
97. Utilization of the International Computer Access Service (ICAS)	B	It will be studied, together with the studies on the institutions of data communications as a whole.
Ministry of Home Affairs (Fire Service Law)		
98. Acceptance of tank containers, based on the EC standards in regard to the transportation of dangerous materials	A	As regards tank containers for international trasportation, which meet the IMCO standards. Article 23 of the Government Ordinance concerning the regulations for dangerous materials will be applied, and based on the condition that the installment of tight linking facilities, based on the ISO standards, on automobiles, will be made obligatory, land transportation to the place of destination will be permitted, without the installment of partitioning boards, shock-absorbent boards, etc.
Science and Technology Agency (Law Concerning Prevention from Radiation Hazards due to Radio-Isotopes, etc.)		
99. Easing and lightening of inspections and proof, concerning the transporting of radioactive isotope	C	Not a few points of Canada's requests stem from misunderstandings. However, the Japanese government is looking for the possibilities to simplify the inspections and proof procedures. For this purpose the government is seeking enough information on the examination system of the Canadian side.

Gov't Decision on Improvement of Import Testing Procedures and Tariff Cuts

Made on Jan. 13

Improvement of Import Testing Procedures

	Item	Details of Measures
1.	Additions to the use of already approved ingredients of cosmetics.	At present, 1,000 permissible ingredients have been published. In addition, approximately 800 more will be published. The list of ingredients to be added has already been presented to the U.S. and the EC in November 1982.
2.	Approval of consumer preference tests on non-approved cosmetics.	Consumer preference tests will be allowed to be given on those cosmetics not yet approved within certain limits, from April 1983.
3.	Simplification of procedures for the transfer of approvals for imports among enterprises.	Procedures for the transfer of approvals for imports of pharmaceuticals will be substantially simplified after April 1983 by elimination of submission of such testing data as was already appended in the previous authorization.
4.	Revision of JAS standards for plywood knots, adhesive strength, etc., and white pockets.	(1) Revision of standards concerning knots and adhesive strength was made after the prior procedures based upon GATT Standards Code and will be implented from Jan. 14, 1983.
5.	Acceptance of foreign test data on animal pharmaceuticals.	(2) Results of the tests on white pockets will be submitted to the Japan-U.S. Forestry Products Committee whose meeting is scheduled to be held on Jan. 24 and 25, 1983. Future revisions of JAS standards will be studied by the Agricultural and Forestry Products Standards Council. Foreign test data on drug stability and toxicity have been accepted since June 1, 1982.

6.	Acceptance of foreign test data for feed additives.	Foreign test data on stability and toxicity are already accepted and steps are being taken to accept foreign test data on basic tests endorsing effectiveness from the beginning of February 1983.
7.	Acceptance of foreign inspection data on high-pressure gas containers.	The High Pressure Gas Safety Association (HPGSA), the containers testing organization under the High Pressure Gas Control Law, has decided to accept test data of foreign testing organizations by commissioning and inspection contracts. The HPGSA is finalizing such a contract with an Australian inspection organization to be completed by February 1983, and is ready to utilize the scheme with other foreign inspection organizations.
8.	Simplification of import procedures for aerosol products.	A ministerial notification will be issued by the end of January 1983 to simplify import procedures for aerosol products, by reducing test requirements for continuous imports or small quantities of imports.
9.	Making the S mark and SG mark on consumer products available to overseas manufacturers.	(1) To facilitate the resolution of the problem of metalic bats, these bats were excluded from the scope of the Consumer Products Safety Law, effective January 6, 1983. Adjustments with the parties concerned to allow manufacturers overseas to enjoy advantages substantially equivalent to those enjoyed by Japanese manufacturers under the S mark system are in progress. (2) Overseas manufacturers will be given access to the SG mark system operated by the Product Safety Association before the end of January 1983.
10.	Adjusting technical standards for electrical appliances and materials to be brought in line with international standards.	Efforts to revise the technical standards for electric appliances including home electric appliances will continue to the end of Fy 1983 in order to make the standards under the Electrical Appliance and Material Control Law consistent with the IEC Standards.

11.	Acceptance of foreign inspection data for electric appliances.	The Japan Electric Testing Laboratory set up a scheme to mutually accept data by conducting a contract with U.S. and Canadian inspection organizations in December 1982. A similar scheme will be considered for other foreign inspection organizations which request such treatment.
12.	Participation of foreign manufacturers of air conditioners in the private level inspection system.	The Japan Refrigeration and Air Conditioning Industry Association is in the process of adjusting the procedures for the testing of room air-conditioners to ensure that room air-conditioners manufactured overseas qualify for its testing system. The target date is the end of February 1983.
13.	Expansion of the number of cars entitled to apply for simplified examination procedures as a small-quantity motor vehicle category.	Limitation of the number of motor vehicles which are entitled to apply for simplified handling as a small-quantity motor vehicle category will be expanded from the current level of 100 units to the level of 300 units as of March 1983.
14.	Active participation in the work of international harmonization of automotive standards.	Active participation in the activities for international harmonization of automotive standards by the Experts Group on the Construction of Vehicles of the U.N. Economic Commission for Europe is being carried out.
15.	Designation of additional foreign official testing institutions for foreign automobiles (in addition to the already designated 9 institutions).	Foreign official inspection institutions wishing to have their inspection results accepted will be further designated promptly after the necessary checking procedures.
16.	Acceptance of the certification by the designated foreign notary public of the dates of manufacture for imported automobiles.	In addition to the acceptance of manufacture dates certified by official organs in EC countries and Sweden, measures have been taken as of November 1982 to accept the certification by a U.S. notary public of the dates of manufacture of the motor vehicles. Future applications for the same procedure by other countries will be accepted after necessary checking procedures.

The Japan Lawletter (January 1983): 58

Bill passed on inspection and standardization for imports

The House of Councillors approved last Wednesday a package of 16 revised bills designed to improve the standardization and certification system of imported goods, thereby abolishing the much-criticized and complicated importing procedures and further opening Japanese markets abroad.

Officials of the Ministry of International Trade & Industry said the package includes a revised Pharmaceutical Law and Road Vehicle Law, and expressed hope that its passage will encourage imports from abroad and alleviate Japan's trade frictions with western countries.

Observers said the recent passage will facilitate imports of foreign goods to Japan. One revised point was that the new law permits foreigners to directly register the sale of foreign goods in Japan and make an application for certificates which guarantee the safety of the imported goods with the government authorities. In the case of foreign cars, only import agents in the past could make an application for sales certificates enabling the agent to sell imported vehicles in Japan. But Diet approval now means that foreign automakers can file directly such an application with the Transport Ministry, facilitating sale of their cars in Japan.

Foreign medicines will also be easier to sell in Japan as a result of the revised bills. Previously, foreign pharmaceutical companies had to file an application to sell new medicines through importing agents in Japan, but the new law includes a provision that foreign companies can file directly Health & Welfare Ministry. Furthermore, if a company wants to import and sell a new foreign medicine which was previously approved by the Government for sales by another company in Japan, the company in question will have to file a completely new set of data just as though the medicine is being imported for the first time. But the recent Diet passage will make it much easier for the second company to sell such medicine which has already been sold in Japan.

Another revised point is that if a given type of certificate was once granted to a package of sample goods by the Government, foreign companies can export the same type of goods to Japan without having to seek new approval from the Government. Previously, foreigners had to get approval from the Government for any goods whenever they wanted to export them. Goods covered by the new laws include pressure cookers, liquefied petroleum gas heaters and instant gas heaters. In addition, foreign canned foods and farm products will be able to obtain a Japanese Agricultural Standards (JAS) mark, making it unnecessary for each respective can or product to be checked each time.

The Japan Economic Journal (24 May 1983): 1, Col. 1

13: INNOCENTS ABROAD OR PARTNERS IN DEVELOPMENT? AN EVALUATION OF CANADA-INDONESIA AID, TRADE AND INVESTMENT RELATIONS

Geoffrey B. Hainsworth

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INNOCENTS ABROAD OR PARTNERS IN DEVELOPMENT? AN EVALUATION OF CANADA-INDONESIA AID, TRADE AND INVESTMENT RELATIONS

Introduction

Most analysts would now agree that economic growth in the countries of ASEAN has remained consistently more buoyant than in any other region of the developing world. It is therefore not surprising that many have suggested that economic recovery in Canada or in other industrial countries could be greatly enhanced if there were more economic links with these dynamic "engines of growth".

Within ASEAN, Indonesia is often pictured as being the most fabulous arena of opportunity for foreign business operations and yet the most elusive and intractable when it comes to actual negotiations and implementation of joint and other commercial ventures.

This report will review Canadian economic involvement with Indonesia under the New Order administration, since 1967. It will provide a commentary on past performance and will seek to illuminate the economic potential as well as the problems in building further exchange and partnership arrangements. The discussion is organized into four parts:

- an introductory section, describing the evolving relationship and the pressures for mutual accommodation in the context of the current global recession;
- an overview of what has been accomplished in terms of stepped-up economic assistance, commodity trade, and

international joint ventures involving Canadian firms;

- an appraisal of Indonesian development problems, priorities and prospects, both in the years immediately ahead and in a longer perspective; and
- a conclusion, which evaluates Indonesia as a "context of opportunity" for Canadian interests and examines what role Canada might be called upon to play as a partner in development for Indonesia in the future.

Canada's Revitalized Dialogue with Indonesia and ASEAN

A re-evaluation of Canada's potential interest in Southeast Asia ("after Vietnam") began soon after the formation of ASEAN in 1967. This was also the year of transition in Indonesia from Sukarno's Guided Democracy to Suharto's New Order administration. The first event signalled the likelihood of greater political stability and economic security in the region, and the latter event restored Indonesia's membership in the World Bank and the world of international finance and once again opened the doors to foreign business. New opportunities for Canadian aid, trade, investment and banking in Indonesia were quickly recognized, and in Trudeau's celebrated "Mansion House Speech" in 1970, Indonesia was uniquely singled out among ASEAN members as meriting special attention for international economic assistance.[1] In the 1970s, Canada's bilateral aid commitments in the region were shifted almost exclusively to Indonesia as a "country of concentration", away from the previous Commonwealth and Colombo Plan links with Malaysia and Singapore.[2]

Formal Canada-ASEAN economic relations date back to the 1975 regional development assistance program and have culminated in an agreement for "industrial, technical and commercial co-operation" in June 1982 and the inauguration in Ottawa in April 1983 of "five-plus-one" Canada-ASEAN Joint Co-operation Committee meetings, to be scheduled on an annual or more frequent basis. The evolution of such pan-ASEAN arrangements and negotiations reflects the emergence of greater unity of perspective and increased economic co-operation among ASEAN members. There is, as well, a realization that these countries can in this way achieve greater combined bargaining power. (Similar five-plus-one committees have been set up with the United States, Japan, Australia and other trading partners.) Such an evolution could also give Canada more leverage in securing uniform or at least similar terms and arrangements in the aid, trade and investment relations that are undertaken with each ASEAN country. For practical and political purposes, however, aid agreements, trading treaties and rules for foreign business operations will continue to be arrived at mainly on a bilateral basis and will be subject to change according to the needs and stipulations of each sovereign nation. In the forseeable future it seems unlikely that further formal economic and political integration will be achieved within ASEAN.

Indonesia represents 57 per cent of the total population of ASEAN, 63 per cent of its land mass, and 42 per cent of its combined GNP. (See Table 1) It is, in fact, the world's fifth largest country in terms of population, and the third largest developing country (after China and India). Indonesia thus merits much more attention in global affairs than it currently receives. Economically, it attracted increasing attention during the 1970s, partly because it was a major producer in OPEC and the country from which Japan continues to draw much of its energy supplies. Over the course of several years, Indonesia has also been the largest borrower from the World Bank, but its resource wealth and relative financial prudence (at least since the Pertamina crisis of 1975) have saved it from the fate of debtor nations such as Brazil, Mexico or the Philippines. In the ASEAN tradition of export-led growth, Indonesia is the great-grandfather of export economies. Even before Columbus tried to find his way to these fabled spice islands, traders and resource developers in Indonesia were ready to keep the riches flowing faster than the debts could accumulate. Indonesia's wealth is distributed over some 13,677 islands, making Indonesia the most fragmented and, according to many, the most fascinating country on earth.

For its part, Canada has made concerted overtures--in the form of prime ministerial, ministerial, diplomatic, technical, professional and commercial missions--to Indonesia and ASEAN with accelerating intensity over the last sixteen years. A quarterly Canada-ASEAN newsletter is now produced and widely circulated by External Affairs to publicize the exchange between Canada and those countries, and Export Strategy and Industrial Cooperation booklets are available on a regional or country-by-country basis. The increased volume of trade, aid and investment has resulted in a larger number of trade and CIDA staff being posted to Canadian missions in ASEAN countries. Although press coverage in Canada remains sporadic--lapsing towards total neglect in the absence of spectacular events such as a prime ministerial visit, a volcanic eruption, or a major assassination--attention is bolstered from time to time by Pacific Rim Opportunities Conferences and Op-Ed articles heralding the fabulous potential that the region holds for Canada, if only the means can be found to realize it.

The expanding Canada-Indonesia dialogue serves a range of interests, not the least of which is the political need on both sides to find a broader arena and to achieve a higher profile in international affairs, as well as the need to dilute what seem to be excessive dependency relationships: of Canada on the United States, and of Indonesia on Japan and on the United States. Canada is often considered as "another North American country" without conspicuous predatory intent, a country that also offers a possible testing ground and gateway to the larger market. Indonesia is a very large but not overwhelming country, where foreign aid can show tangible results; it also provides a raison d'être for a Canadian presence in Southeast Asia, now that Canada no longer serves on the International Commission in Vietnam,[3] and now that Commonwealth ties with Malaysia and Singapore seem to be less meaningful. There is a need for special efforts in Canada-Indonesia relations because compared to other ASEAN countries Indonesia has only a tiny and temporary resident community of Canadians, and the expatriate Indonesian community in Canada is relatively small. Knowledge of the culture of the other is thus very limited, especially as Bahasa Indonesia is not being taught in any Canadian university--though it is the world's sixth largest language group--and English is not as prevalent in Indonesia as elsewhere in ASEAN.

There is enough common ground between Canada and Indonesia to justify an effort at greater understanding and a more animated dialogue. Both have traditionally been "export economies" and continue to rely significantly upon export-led growth for their prosperity (with ratios of exports to GDP of 27 per cent and 30 per cent respectively for 1982). Both are mainly primary producing countries, with high shares of GDP originating in agriculture, forestry and mining, though Canada's smaller ratio of population to resources (and special access to North American technology and investment) yields a higher per capita GNP. This in turn has helped Canada develop a larger and more sophisticated manufacturing sector, in part through public subsidy. As primary producers and exporters, Canada and Indonesia are competitors in some commodity lines, potential competitors in others, and clearly non-competitive in only a few lines, where different climatic zones or unique resource endowments are determining factors. Similarity in commodity structure can make them potential allies in commodity agreement negotiations, and can also facilitate industry-specific technology transfers, especially in the case of multinational firms with interests in both countries. Both are substantial debtor nations, borrowing against resource endowments, and both are "host nations" to foreign firms that own or manage significant shares of their domestic productive capacities. Canada is also a creditor nation (with some investments in Indonesia and elsewhere) and, being a higher income country, Canada is an aid donor nation, while Indonesia is a substantial aid recipient. Canada's geography, with its population and infrastructure strung mainly along a corridor 100 miles high and 4000 miles long, has evident similarities with Indonesia, which suggests further opportunities for transfer of technology and accumulated know-how in this regard. Aside from transport and communications, there is potential for an exchange of expertise in areas relating to regional development, social service administration, and adaptation of technology to dispersed communities and relatively small-scale operations (as in power and other utility supply, agricultural servicing and storage facilities, and municipal and community development). Finally, Canada and Indonesia are both political conglomerates, with considerable regional diversity, ethnic factionalism, and with consequent problems in maintaining national cohesion and identity.

There is thus much fuel for dialogue. Spelling out such a list of seemingly "obvious" similarities and differences helps to draw attention to the "peculiar relationship" that exists and is in process of evolving between the two countries. The peculiarity, from an economic viewpoint, stems mainly from the Canadian side--given that Canada is "a rich underdeveloped country, a debtor and creditor nation, and a high income primary producer". This accounts for some of the almost hypocritical ambivalence and fence-sitting propensity exhibited by Canadian spokesmen when it comes to such North-South issues as: commodity agreements, codes of conduct for multinationals, international financial reform, law of the sea and global commons, and protectionism, particularly the dismantling of tariff and non-tariff barriers that limit access of developing country manufacturers to markets of industrial countries. This Canadian abnormality places a special onus on Canada's representatives in the Canada-Indonesia (or broader Canada-LDC) dialogues to make it clear when and why particular considerations may apply. Canada's credulity can be seriously strained when it champions Third World issues as a "soul brother" in international fora, and then follows a domestic practice that is at glaring odds with what is being preached. To avoid a reputation for "speaking with forked tongue", Canada must make clear to Third World partners when it can be counted as "one of us" and when it must behave as "one of them". Having it both ways risks not having it at all.

Governments in Canada and in Indonesia are set upon diversifying their national structures of production away from "excessive" primary producer dependency ("rocks and logs" in Canada, "petroleum, padi and plantations" in Indonesia) and are seeking to create more jobs through industrialization. Both countries can be described as relatively "interventionist" and "protectionist", and yet each lacks a clear industrial policy that would serve to determine specialization within manufacturing when this is not dictated by dramatic resource advantages or by overwhelming international competition. Lacking clear criteria, both countries are prepared to subsidize, up to a certain level, almost any production on "infant industry" arguments or where a strong political case could be made for the need to promote job creation or regional economic balance. Such subsidy arrangements carry over into export promotion, especially in times of recession when foreign exchange earnings from primary exports are exceptionally depressed and lifestyles built on high imports are threatened by balance of payments crises. Canada and Indonesia both exhibit what have been called neo-Mercantilist tendencies.

Under the pressure of the current prolonged recession, Canada and Indonesia are thus very anxious to increase exports of anything by whatever means possible, and both are increasing their barriers to imports. All transactions and political deliberations, from foreign investment and foreign aid to pollution laws and wage negotiations, are looked at in the context of short-term effects on the balance of payments as much as in the context of the longer-term effects on economic development and the quality of life. Such myopic fixation is not compatible with a belief in international trade as an engine of growth. The latter is concerned with optimal resource allocation guided by some concept of comparative advantage and gains through trade from specialization. It requires that a country discriminate on the basis of efficiency against some forms of "infant industries" so that those that do have the capacity can receive the resources to grow to self-sustaining adulthood. When productive agents are unemployed across the board and no means exist for discriminating analysis, however, the natural tendency is to push everything at once.

From an economist's viewpoint, this is generally regarded as the wrong approach for analyzing international trading accommodation in bilateral terms (in spite of the prevalence of two-country/two-commodity models in economic texts). When there is a faith in multilateralism, bilateral balances can be ignored so long as a country's overall balance of payments is not in chronic deficit or surplus. Where it is in chronic deficit, correct policy calls for structural adjustment, domestic deflation or devaluation to set things right. That politicians and their advisors have been forced to think and negotiate increasingly in bilateral terms reflects "a breakdown in the international system", or at least some loss of faith in its ability to work. This implies a lack of willingness overall to abide by the rules of discipline of the international system in determining comparative advantage, or a sense that others can manipulate the terms so as to take excessive shares in gains from trade and specialization.

The current crisis is not simply a short-term response to OPEC price hikes, high US interest rates, or unions pushing up wages faster than productivity. At the root of the problem is the fact that most nations are simply not prepared to have their economic momentum and their economic structures determined exogenously by international market forces, competitive or otherwise. This is particularly the case for developing countries, which are insistent on improving their productive structures and terms of trade after decades or centuries of what they interpret as an imposed global division of labour relegating them to "cheap, labour-intensive, low technology, high risk, overly competitive, primary producing industries". Less defensibly, resistence to exogenous control is also characteristic of highly diversified industrial nations unwilling to "vacate the field" in inappropriate "backward" industries or to increase their vulnerability to international competition.

What this has led to is a global structural disequilibrium and a series of stand-offs, with nations doing what they can unilaterally to promote industrialization in their own countries, to push whatever they can onto export markets to pay for "essential" imports. and to bargain bilaterally and in small regional groupings to ease some of the strain by "second-best" adjustments in lieu of multilateral accommodation. The Canada-Indonesia dialogue is one of such bilateral negotiations, at least in part, and there is a tendency now towards linkage and packaging in order to bring everything onto the table and to thus obtain concessions and special agreements. Insofar as the momentum towards freer multilateral trade as promoted by

GATT and the various "Rounds of Talks" seems somewhat in abeyance,[4] other suggestions have been voiced for selective customs unions and regional free trade areas (such as Canada-United States, or ASEAN, following the example of EEC) as explicit second-best alternatives. Should such linkages appear too confining, as in the case of Canada-United States trade relations, or inoperable, as the various Pacific Rim free trade area proposals now appear to be, we are left with the "third option" of seeking to promote tariff reform and improved trade relations on a bilateral country-by-country basis.

The third option--bilateralism--is essentially where most Canadian efforts have recently been directed, though there is evidence that the aversion to closer US links may currently be abating, perhaps out of desperation.[5] Indonesia meanwhile finds itself courted by other ASEAN members, who have more developed industrial sectors and smaller domestic markets, and who advocate freer intra-ASEAN trade and closer economic integration. While making some moves in this direction, Indonesia is also actively manipulating its third option with all its industrial trading partners, seeking broader and more profitable trade, aid and investment interrelationships. This reminds us that Canada is not alone in giving revitalized attention to its Indonesian connections. In fact, its stepped-up efforts lag notably in many respects behind the rushing crowd of potential partners in development from Japan, Hong Kong, other East Asian NICs, Australia, West Germany, Holland and several other EEC member countries. Its network of economic relations is thus subject to continual and close comparison.

What does Canada want out of the dialogue in economic terms, and what does it have to offer? From Indonesia's viewpoint, how indispensable is its Canadian connection as a source of aid, trade, investment and other benefits? From the Canadian standpoint, how important is Indonesia as a political ally, and as an outlet for Canadian products, lending, and investment? Where are the areas of mutual benefit, and what are the points of conflict and contradiction between helping Indonesia develop and helping oneself to Indonesia's wealth? How pragmatic and Machiavellian must we be in pushing particular

Canadian commercial and political interests, perhaps at the risk of losing longer-term good-neighbour relations? What is the bottom line, and how resilient and flexible can Canada be in accommodating Indonesia's demands, especially those that would have unpopular effects in Canada?

These are the questions that need to be answered in a full-blown review of Canada-Indonesia political-economic relations. What follows is only a partial excursion towards understanding what is involved, especially in regard to aid, trade, and investment relations somewhat narrowly defined. It is hoped that this paper might illuminate the territory for decisions that must be political, not merely economic, whether these be carefully deliberated or made, for the most part, in haste. Where objectives, trade-offs, and strategies are not clearly spelled out, one must deduce these from "behaviour as revealed preference". As things look at present (summer of 1983), Canadian foreign policy, and the Canada-Indonesia dialogue, seem to be headed in an increasingly neo-Mercantilist direction.[6]

An Overview of Canada-Indonesia Economic Relations

Persistent global recession and the apparent lack of adequate solutions to Canada's regional development and unemployment problems have prompted a major reorganization towards a realpolitik approach in that part of the federal establishment that is concerned with foreign affairs. Starting in October 1983, after several years of preparation, all agencies with extra-territorial responsibilities will be linked by committees and a system of hierarchical reporting on a country-program basis. All aspects of foreign policy will be continually and explicitly assessed in terms of their tangible (especially short-term) benefits to Canada and to the needs of various specific regional problems across the country.[7] The monolithic structure is still experiencing teething problems and has yet to prove itself operational; it is quite possible that a change of government will modify and simplify the edifice before it is really put to the test. But it appears that both Liberals and Conservatives agree: commercial considerations must be kept uppermost and must be closely calculated in all international dealings if Canada is to regain prosperity and elbow its way back up the pecking order among industrial nations.

As with Canada, Indonesia policy-makers are also acutely attuned to all international dealings. Indonesia is feeling the pinch of reduced foreign exchange earnings and government revenues and is finding it more costly to borrow against the future. To make matters worse, the World Bank reclassified Indonesia in 1980 as a "middle income country", albeit inadvertently, thus making it ineligible to borrow on the most concessional terms. While OPEC still survives, it is acting more as a price stabilizer and an enforcer of production cut-backs than as a promoter of ever more bountiful revenues for its members. Even within ASEAN, there is an undercurrent of intensified competition for markets, loans, and job-creating foreign investment.

As a result, Indonesia has also been forced to adopt a more canny and calculating posture in its international dealings. It is bargaining more insistently and more urgently for special concessions and is seeking to maximize its share in gains from trade, aid, and foreign investment. Counter-trade rules have been imposed, requiring foreign-based suppliers under government procurement contracts to purchase and/or export an equal value of Indonesian goods from specified lists. The terms of aid commitments are being disputed more laboriously, and one donor country is being played against another. The rules pertaining to foreign business operations within Indonesia are steadily being made more stringent and demanding in terms of indigenous participation, use of local employees and contractors, and tax and dividend shares. At the same time, more vigorous campaigns are being launched to attract new foreign investors, especially very large agribusiness and manufacturing enterprises, to create more jobs, more joint ventures, and more capacity to generate income and foreign exchange in non-traditional ways.

The spreading erosion of faith in multilateralism and the capacity of the international system to cure itself has made bilateral wheeling and dealing more prevalent and much more crucial to both industrial and less-developed countries--and especially to primary exporters in all categories. Conditions of glut in most commodity markets make sales more dependent on the special deals that can be arranged than on price or customary bidding. More linking and packaging, more hidden discounts and subsidies, and more flexibility and pragmatism now characterize such bilateral relations. It is in this perspective that we review Canada-Indonesia aid, trade, and investment relations as they developed in the 1970s, and as they will need to be amended in the course of the 1980s and 1990s.

Canada-Indonesia International Aid Relations

In the period 1967-82, Indonesia's total foreign-aid receipts cumulated to around US $15 billion (US $7 billion in multilateral and US $8 billion in bilateral economic asistance). Allowing for some repayment and interest accruing, and including some US $11 billion in recorded government debt to private financial institutions, Indonesia's total outstanding debt by the end of 1982 exceeded US $30 billion. (See Table 2) Servicing this debt, including some high rate of interest contracts incurred in recent years, meant that the actual annual net transfer of funds for 1981, for example, was only US $588 million, compared to a total of US $5 billion in new aid commitments for that year. A large share of new aid, on financial account, is therefore channeled to service obligations incurred from past borrowing and economic assistance.

Canada's cumulated bilateral aid contribution to Indonesia for the period 1968-82 came to US $237.69 million, or about 3.5 per cent of Canada's total disbursments for that period. (See Table 3) Canada ranked sixth in bilateral aid contributions to Indonesia, behind Japan (US $2.73 billion), the United States (US $2.27 billion), West Germany (US $728 million), France (US $722 million), and Holland (US $634 million). As the figures in Table 3 indicate, however, Canada's bilateral aid has not been a steady or steadily growing contribution over the period of 15 years. In the 1970s, for example, there were discrete jumps in outlays for the fiscal years 1972-73, 1973-74, and 1975-76, achieving a record peak of Cdn. $36.7 million, followed by four years of declining outlays until they picked up again in the 1980s. Selecting periods for comparing Canada's aid performance over time can thus be treacherous and misleading. For example, the average level for the three fiscal years between 1979 and 1982 is 582 per cent above that for the three fiscal years between 1969 and 1972, but it is only 79 per cent above the average level for the 1974-1977 period. Cumulated or annual commitment figures are even more misleading, as substantial amounts of these may never be disbursed.

In the 1980s, Canada-Indonesia aid disbursements have been expanding rapidly, from Cdn. $11.75 million in 1979/80 to Cdn. $28.84 million in 1982/83. In Canada's "countries of concentration", Indonesia now ranks fifth--after the countries of Bangladesh, Pakistan, India, and Sri Lanka, which are often referred to as the South Asian poverty belt--and seems likely to retain this high priority. Canada pledged a commitment of US $32.41 million (Cdn. $39 million) at the June 1983 meeting of the Inter-Governmental Group of aid donors for Indonesia (IGGI), which represented about 5 per cent of total bilateral commitments. Canada also finances about 4 per cent of the overall multilateral assistance of the World Bank and 7 per cent of that of the Asian Development Bank (ADB). Indonesia was pledged US $1677 million from these sources for 1983/84 at the IGGI meeting.

Currently Canada has close to 40 ongoing bilaterally funded projects in the planning or implementation stage in Indonesia, involving an accumulated commitment of around Cdn. $250 million. Disbursements lag several years behind commitments--one of the major criticisms levelled at aid administrators--and quite often do not reach implementation stage, one reason being the lack of sufficient counterpart funds or other commitment from the Indonesian central or local government agencies. (This also applies to World Bank and other country aid, especially under currently prevailing financial stringencies, outlined more fully below.) Non-utilization of aid appropriations is also often the result of Canadian contractors and suppliers being deemed unacceptable from Indonesia's viewpoint, either because their bids are uncompetitive or because they have not established the right connections or demonstrated sufficient prior commitment as partners-in-development on similar projects.

Canadian bilateral aid projects are concentrated rather heavily in transportation, power, and water schemes, though smaller allocations are made to a range of technical assistance projects and as matching grants in support of Canadian and international non-government organization (NGO) activities. Examples of current Canadian projects include, in Canadian dollars: the Banda-Aceh highway improvement ($47 million), the Sulawesi road improvement ($3 million), the extension of rail facilities and supply of locomotives and rolling stock for the Bukit Asam coal project ($45 million), improving the civil aviation network ($27 million) and the fertilizer distribution network ($20 million), the Lombok high level river diversion ($14 million), the Solo River irrigation feasibility study ($12 million), other water resource development ($10 million), supplying three diesel generators for rural electricity supply ($26 million), support for the Samarinda forestry vocational school ($9 million), a veterinary training project ($3 million), and a fisheries development project ($1.3 million).

Although mostly in the form of loans (for thirty or fifty years at concessionary rates of interest), Canadian bilateral economic assistance has a larger grant element than most other country bilateral aid. It is, however, among the most restrictive in terms of the 80 per cent Canadian sourcing and 66 per cent Canadian content required for disbursement. It is often labelled as a give-away program to Canadian producers of heavy equipment and Canadian consulting services, who otherwise might not be competitive on world markets. Canadian contractors benefit immensely from CIDA projects yet they fare less well in bidding on international tenders, particularly on bids for multilateral aid funded projects. (Canadian firms have in fact the poorest record among major donor nations in this regard, gaining back in contracts about 47¢ per $1 of Canada's contribution to the World Bank, and 9¢ per $1 given to ADB projects, compared to $2.09 and 34¢ respectively for Japan, and $1.64 and 32¢ for West Germany.)

Over the years, the Indonesia program has in many ways served as an experimental model, as CIDA is devising new types of aid agreements with regard to funding formulas, program content, and mode of implementation. There have been mixed reports in evaluating the outcome, depending on the objectives emphasized and the assessment criteria applied. One such experiment was the parallel CIDA-EDC financing applied to the Tanasa II cement project in the early 1970s. CIDA committed $25 million and EDC (with commercial banking participation) committed $150 million to be used on a pro rata basis. Difficulties in finding competitive bidders on equipment to satisfy the Canadian content requirements kept the level of utilization at around 50 per cent of funding committed, and the arrangement was allowed to lapse in 1981. A similar arrangement is involved in the current Bukit Assam project (with $45 million CIDA and $140 million EDC financing), parts of which seem to be running into the same sort of difficulties.[8] Careful case study of these experiences would help illuminate both the problem of reconciling aid with commercial considerations in economic assistance, and that of client receptiveness to such endeavours and their effect on broader Canadian-Indonesian relations.

Of all Ottawa agencies that fall under the new realpolitik, the employees of CIDA may feel the most consternation and confusion. The high Canadian content rule has always meant that a major operational requirement in bilateral aid disbursement must be to find a "mutual coincidence of wants", matching an excess supply capacity in Canada with an unsatisfied need in a recipient country--of which food aid provides the classic example. But CIDA could ostensibly define its mandate as "primarily" to assist development and to alleviate poverty in Third World countries. The analysis was presumed to start with an assessment of need in poorer countries, followed by a search for a matching supply capacity, not with an imperative to dispose of unsaleable items, or to assist with job creation or production expansion in particular regions of Canada. Canadian commercial interests were supposedly left primarily to the Department of Industry, Trade and Commerce to represent, and the different perspectives and objectives have been a source of wrangling, negotiation, and compromise between the two since CIDA first came into existence.

On the other hand, Canadian aid has been caricatured as "mostly pouring concrete and installing machinery", with allegedly dubious relevance to the well-being of the majority of Indonesian or other LDC citizens. CIDA can respond by pointing to its many rural development and technical assistance projects as well as to its NGO support and can argue that allocation is mainly determined by Indonesian government priorities that it cannot rearrange. But it is also true that, given its small and highly centralized staff (90 per cent of whom are based in Ottawa) and the large volume of funds to be processed, CIDA is structurally geared more towards handling a few large-scale, standardized, capital-intensive, and largely self-regulating projects than it is to handling a large number of less tangible or people-oriented projects. If the latter is what is needed, then a wholly new institutional arrangement and new terms of reference are called for, requiring many overseas staff (or reliance on other Canadian institutions such as universities and NGOs) to administer and monitor its programs.

The International Development Research Centre (IDRC) provides to Indonesia and to other LDCs another form of technical assistance, which emphasizes LDC initiative in identifying technical assistance needs and in carrying through project implementation. Unlike CIDA, the IDRC provides assistance wholly in the form of grants, with no restrictions on Canadian content. The IDRC operates completely independently of CIDA, providing support mainly for research and development within Third World countries in finding technical solutions for specific development problems in the fields of nutrition and agricultural science, health and population studies, social sciences, and information sciences. While a new Co-operative Program has recently been added, linking Third World scientists with Canadian counterparts, IDRC has no mandate to promote particular Canadian economic or other interests overseas. Its total budget for 1982/83 amounts to Cdn. $45.9 million, and of a total $266.5 million project budget for the years 1970-83, about $12.5 million went to projects located in Indonesia. There are also Canadian NGOs such as CUSO, CESO, CARE, Canada World Youth, Foster Parents Plan, that provide support and personnel for health, education, and community development projects in Indonesia--although they seem proportionately less active there than in African, Latin American or other Asian countries.

Funding for such "humanitarian" economic assistance has become increasingly difficult to find and justify politically in the increasingly stringent eighties. In Canada, the "self-interest backlash" was complicated by Prime Minister Trudeau's intensified efforts on the North-South interface, culminating in the "spectacle and disenchantment" of the Cancun Conference. CIDA appropriations have increasingly been subject to hard-nosed scrutiny to assess direct returns to Canada, and aid content has had to be more systematically justified in terms of the "multiplier effects" that can be claimed for private commercial penetration and profitability. How CIDA will manage to preserve its "special relationship" with Indonesia and other client countries, including its participation in the broader donor community (through IGGI for example), remains to be seen. It does seem to be giving a new emphasis to "social and cultural" phenomena in its working papers and consultancy, perhaps as a way to highlight its distinctive sphere of responsibilities. It is increasingly utilizing Canadian universities and NGOs to implement components of its program.

But CIDA is also conspicuously reiterating its commitment towards the Canadian business community, which emphasizes the benefits that international economic assistance brings home for Canada. The shift in modus operandi, program content, and terms of negotiation for CIDA will also be conditioned by what happens in the resurgence of neo-Mercantilism in other countries, and how this might alter the whole paradigm of foreign aid and the broader North-South dialogue. In the meantime, we can expect closer business-government collaboration in shaping the terms and content of Canada-Indonesia aid, and closer alignment of this with Canada-Indonesia trade and investment interrelationships.

Canada-Indonesia International Trade Relations

The level of Canada-Indonesia commodity trade has also shown dramatic rates of increase, from initially insignificant levels in the course of the 1970s, peaking in 1980 at a level of Cdn. $244 million (exports plus imports), falling back to about Cdn. $131 million for 1981 and partially recovering to just over $227 million for 1982. (See Table 4) These are, however, miniscule figures relative to each country's total trade, representing about 0.04 per cent of Canada's global commodity trade and about 2 per cent of that of Indonesia. For the 1980-82 period, Canada's trade with Indonesia accounted for 18.5 per cent of Canada-ASEAN trade, while Malaysia accounted for 18.8 per cent, Singapore 30.3 per cent, the Philippines 17.2 per cent and Thailand 15.1 per cent (though part of Singapore's share comprised trans-shipments to and from Indonesia and other ASEAN neighbours). Considering Indonesia's shares in population and combined GNP of ASEAN, this may seem a poor performance for what had long been Canada's only "country of concentration" in the region, involving substantial export promotion and subsidization through bilateral aid projects. Canada ranked seventh in 1982 among commodity exporters to Indonesia, after Japan, the United States, Hong Kong, Singapore, Australia and West Germany.

Despite its poor export showing, Canada's trade balance with Indonesia is strongly positive, indicating an even worse performance from Indonesia's standpoint in Canada accepting that country's exports. Canada ran a positive trade balance with all ASEAN countries except Singapore in 1982, but the balance was most skewed against Indonesia, with exports of Cdn. $197 million set against imports from Indonesia of only Cdn. $30 million; this gives a ratio of 6.5:1 (with equivalent ratios for 1981 of 2.5:1 and for 1980 of around 7.5:1), as against 1.7:1 for ASEAN as a whole. Despite lip service to multilateralism as a mechanism and as an ideal, this imbalance is a source of serious contention in bilateral trade negotiations.

The story of Indonesia's exports to Canada is summarized in Table 5 and can be simply told. Crude natural rubber accounted for 63 per cent of the total in 1982, and 76 per cent in 1981. Indonesia displaced Malaysia as the main source for Canadian rubber in the 1970s (and more Indonesian rubber plus some "smuggled" Malaysian rubber is also imported from Singapore). The bulk of the remainder of

Indonesian exports to Canada in 1981 and 1982 consisted of other plantation and estate crops, and all except tea have registered abrupt declines in recent years.

With respect to the export of manufactured goods, Indonesia has had difficulty breaking into Canadian and other industrial markets. Although it has built up a great deal of excess capacity, especially in textiles, in anticipation of taking over some of the cheaper and more labour-intensive lines from other ASEAN and East Asian exporters, Indonesia has been disadvantaged as a "late-comer" by the tariff and non-tarriff barriers erected against the wave of imports from the previous generation of late-industrializers, especially Hong Kong, Taiwan, and South Korea.

Canada and other early-industrializers are still seeking to protect remnants of their own uncompetitive textile and other labour-intensive industries. Some accommodation to allow Indonesian tailored cotton shirts into Canada has been arranged, but it will still be a struggle to increase and diversify the flow of commodity trade so as to redress somewhat the trade imbalance between the two countries. Exporting to Canada is also made exceptionally difficult by idiosyncratic requirements on bilingual labelling, stringent specifications for electrical appliances, and a host of other non-tariff barriers. The need to observe the vagaries of provincial regulations and to take account of the dispersed nature and variation in regional demand also add to the difficulties.

Part of the problem undoubtedly lies with the Indonesian business community itself, and especially with the chambers of commerce that are notorious for "the dead hand of inertia and regulation" that they impose upon the more aggressive and innovative sections of their membership. Compounding the problem is the government's ambivalent attitude towards its ethnic Chinese middle-class business community, obstructing their initiative in the hope of encouraging pribumi (indigenous, non-Chinese) business enterprise. Pribumi operations are generally small, undercapitalized, and accustomed to servicing the local traditional markets; their small runs and variable quality of output are generally not suited to the bulk buying required for mass marketing in industrial countries. Quality control is also a problem for market expansion. Indonesian coffee that fails to meet International Commodity Agreement (ICA) standards, for example, is often dumped in Canadian and other markets, creating a bad reputation that hinders further market promotion. Economic dualism and sectoral fragmentation of Indonesian industry also discourage Canadian trading firms from seeking closer ties with that country.

Such supply constraints were evident in many instances in the attempts by foreign contractors and their agents to comply with the counter-trade requirements imposed by Indonesia in January 1982. (These came into effect around August 1982, after sustained but futile attempts to resist their implementation.) The rules obligate international suppliers under government procurement contracts to buy and/or export Indonesian goods at a value equal to commodities being imported under the contract. Initially these had to be selected from a short list of specified (hard to export) Indonesian products, but demand for many of them soon outpaced supply capacity and the requirement was thrown open for all except oil and gas products. Initially, the exports were also supposed to be shipped directly to the country of the contracting agent, and to be strictly in addition to customary levels of exports. This would have made a big difference to Canada-Indonesia trade balances, but so far it has been unenforceable. Specialist companies now handle most counter-trade obligations under contract, charging premiums of between 12 and 20 per cent which may be passed on in hidden tendering costs to CIDA or Indonesian contracting agencies, or in lower prices to Indonesian exporters. For the most part, goods go to third-party countries and seem to be comprised of what would have been exported in any case. Volume and value figures for Indonesian exports to all destinations for 1981 and 1982 are shown in Table 6.

Meanwhile, Canada has been making vigorous efforts to increase its exports: to Indonesia, to ASEAN, to anywhere. Even before the recent increase in efforts by Ottawa, many facilities and programs had been launched towards this end. The most important is probably the Program for Export Market Development (PEMD), designed to reduce risks and inertia among Canadian firms competing with foreign rivals for overseas projects or to aid them in coping with new and unfamiliar market conditions. The program is administered under eight sections (or types of facility) of which Section A, providing cost-sharing in bidding on large specific projects, is most important. This is administered centrally from Ottawa, while other sections have been delegated to regional offices across the country. PEMD is receptive to applications from individual firms, but seeks to encourage a consortia approach. Other sections of the program provide cost-sharing up to certain limits for the following:

- market identification trips (Section B)
- participation in trade fairs (Section C)
- visits to Canada of overseas buyers (Section D)
- export consortia feasibility studies and establishment costs (Section E)
- sustained export market development (Section F)
- special subsidies for market development in agriculture, fisheries, and food products (Section R, now called PEMD FOOD)
- assistance to non-profit organizations with activities related to Canada's export trade (Section S).

A total of $124 million has been approved under the PEMD program, between 1971 and 1982, of which $62 million has been allocated, and from which export sales of $5 billion have been claimed. The 50 per cent final utilization has been explained, at least in part, by firms drawing on the facility as a cheap source of operating funds. Strong incentives for utilization exist, however, as advances are only repayable if profits result from the endeavour. There has been a surge in disbursement in recent years, from $13 million in 1981-82, to $21 million in 1982-83, with $27 million projected for 1983-84. Program expenditures for Asia in the 1971-82 period total $8.2 million, of which projects in Indonesia accounted for $1.2 million, 86 per cent of which fell under the Section A category, and to which an additional $0.4 million can be added for 1982-83 (with 83 per cent under Section A). Additional exports of $64 million to Indonesia between 1971 and

1983 have been officially attributed to PEMD promotion. (This implies a dollar-for-dollar benefit/outlay of about 40:1 on the Indonesian trade, compared to a claim of about 80:1 for global returns to the PEMD program.)

The benefits claimed for PEMD trade promotion have been criticised as exaggerated and self-serving calculations put out by those responsible for administering the program. Critics claim that there is no way of telling how much of the trade would have occurred in the absence of the promotion, and how much worse the record might be for Canadian firms bidding on international contracts. In addition, the associated subsidy elements of the promotion have been assailed as a give-away program, especially the subsidies to those larger multinationals which, it can be argued, "should be capable of underwriting their own feasibility studies and market expansion". The waiver of a pay-back for unsuccessful ventures evidently rewards lack of perseverance, and also gives incentive for understating success, such as when sales are attributed to other auspices. The very generous travel allowances and alleged lack of scrutiny of other attributed expenses elicits criticism that PEMD encourages futile and ostentatious abuse at the tax-payers' expense, and suggestions have been made that only partial reimbursement for market exploration and feasibility studies should be allowed. More visits have subsequently been arranged on a country-by-country basis, some headed by the Minister of Trade, and more seminars have been organized in Jakarta and in Canada to bridge the gulf in understanding between businessmen of the two countries and to explore possibilities for profitable collaboration in commercial ventures.

Canada's commodity exports to Indonesia are shown in greater detail for recent years in Table 7. As can be seen, total export values as well as totals for various broad catergories can fluctuate abruptly; this is due mainly to "one-shop" deliveries of materials and equipment under CIDA bilateral aid contracts. (Components funded under CIDA concessional terms, incidentally, were deemed to be exempt from counter-trade requirements, after a vigourous attempt was made to exempt the whole Bukit Asam contract during the Trudeau visit to

Indonesia in January 1983.) Nearly 60 per cent of the 1980 peak-year total, for example, was attributable to a non-recurring delivery of semi-container vessels and a curious sale of bunker fuel, worth $53 million and $73 million respectively; without these, the total value for 1980 becomes Cdn. $88.5 million, well below the 1981 total value. Similar "single year" items in 1982--locomotives and rolling stock, aircraft, fertilizer, wheat, and rape seed oil--account for the extra boost in total export value for that year. The apparant "sharp dip and recovery" in total trade between 1980 and 1983 can thus be misleading as an indication of what was happening to commercial transactions affecting Canadian exporters. One must look more carefully at individual items and categories. Though it is still not possible to isolate commercial sales from commodities shipped under concessional arrangements, some categories where bilateral aid contracts appear to have had a dominating influence can be identified. It is important to allow for this in any analysis of how Canadian producers are responding to commercial trading opportunities and how they might predict their future prospects in competition with other suppliers.

Table 7 is arranged so as to delineate between Canada's familiar resource-based staples, semi-processed materials, and finished manufactured goods. These are relevant in delineating Canada's export prospects in relation to Indonesia's changing development priorities and the shifting currents of what might be called the Greater East Asian Intergrated Product Cycle. The categories also have relevance to Canada's internal needs to balance requirements and political pressures in promoting regional economic development. For the years 1980-82, out of a commodity export value of Cdn. $500 million, primary and semi-processed materials accounted for roughly two-thirds of the total, while manufactured exports accounted for one-third. In general, manufactured products outpaced primary and intermediate goods, but this perhaps could be expected for such severe recession years, especially when CIDA funding was biased toward heavy equipment and other manufactured goods.

Among resource-based exports, two staples stand out--basic chemicals and minerals, and pulp and paper products--plus a "residual" category (mainly food and fertilizer and for 1980 marine fuel), reflecting Indonesia's year-by-year shortfalls and/or CIDA's changing bilateral aid composition. Basic chemicals and minerals (mostly originating in the Western Provinces and Quebec) earned around Cdn. $33 million per year, while pulp and paper (mostly from British Columbia, but supplemented by New Brunswick and Quebec) brought in around Cdn. $21 million per year. Together, these categories accounted for a remarkably stable intake of Cdn. $54 million per year, though value ratios show sharp variation in particular items.

Both Canada and Indonesia are, for the most part, primary producing and exporting countries and are thus competitive or potentially competitive across most commodity lines. A detailed knowledge and insight would be needed if one were to predict future global supply and demand conditions for particular commodities, relative competitiveness of particular suppliers in different market areas in face of new sources of supply, and the potential for technological substitution of synthetics for natural materials.

Nonetheless, the security of future markets for Canadian forestry and mineral exports in Indonesia will need to be continually reassessed in light of Indonesia's rapidly changing development priorities. There is already a booming pulp and paper industry, and current reforestation efforts include a broader overlap of fast-growing varieties that are more competitive with Canadian timber than was previously the case. (Indonesia has recently banned the export of raw logs, and its plywood and other lumber exports are making serious inroads into Canada's traditional markets in the United States and Japan.) There have also been many new mining and mineral processing developments that could affect the rules governing import substitution for Canadian suppliers to Indonesia. Aluminum imports are falling as major bauxite deposits are opening up and smelting capacity is being extended. Other materials are being increasingly substituted for zinc and copper. Asbestos is also becoming more difficult to sell as its hazards to health are recognized and as other insulation materials come onto the market. Sulphur is meanwhile in chronic excess supply worldwide, and Indonesia could easily shift to lower-cost suppliers.

Whatever the motive, Canadian firms (and Canadian aid) are vigorously engaged in helping Indonesia develop its forest and mineral resources, and they should thus be in a good position to predict the necessary adjustments that must be made in Canada's sales forecasts for Indonesia and for the Pacific Rim in general.

With regard to semi-processed and manufactured Canadian exports to Indonesia, two broad commodity groups again might be distinguished: intermediate goods (especially plastics, other synthetics and chemical products originating mostly from Quebec and Ontario, which earned around Cdn. $24 million in 1982, up from previous years) and a range of heavy or "high tech" capital equipment (mostly produced in Ontario and Quebec, but also increasingly coming from British Columbia, Alberta, and the Maritimes with respect to certain specialized equipment in the resource industries, aeronautics, oceanographics, telecommunications and other fields). Several of these commodities have charted spectacular "growth curves" in 1982 or in years previous to that. These are where Ottawa is resting most hopes for achieving a distinctive export role for Canada in the future. But technological stakes and risk elements are most intense in these sectors. As for manufactured consumer goods, they appear as small "residual items" on current accounts, but notable exceptions may be developing, for example, in electronics and other high-innovation fields, in pharmaceuticals, medical equipment, sports equipment, and in educational materials of various types.

Data on bills of lading can be used to gain some preliminary idea of regional origins and benefits within Canada of exports to Indonesia, though trans-shipments can cause confusion. Maritime provinces are thus credited with $37 million in exports, or 19 per cent of the total, for 1982. But this was almost wholly accounted for by two transactions: the sale of railway rolling stock from Nova Scotia ($23.6 million) and aircraft, apparently from Newfoundland ($10.4 million); and the sale of newsprint and woodpulp from New Brunswick ($2.4 million). Quebec's share came to $29 million (14.5 per cent), of which asbestos accounted for $6.6 million, zinc $3.8 million and aluminum $1.0 million, synthetic rubber and plastic materials $7.4 million, with the remaining portion covering a wide range of commodities across the spectrum from primary to finished manufactured goods. Ontario, as might be expected, had the lion's share, totalling $67 million (34 per cent), with the widest range of commodity categories. About 50 per cent of the exports from Ontario were in the form of industrial machinery and equipment of various types, 15 per cent comprised metal intermediate goods, 12 per cent synthetic rubber and plastic goods, 10 per cent textile fibres, and 10 per cent tobacco, rape seed oil and kernels and other agricultural products. Direct exports from Manitoba and Saskatchewan were recorded as being less than $0.5 million, but this omits most of the wheat ($6.8 million) and some of the fertilizer ($4.9 million) and other minerals shown on British Columbia bills of lading. The Western provinces together accounted for around $65 million (33 per cent), with $54 million (27 per cent) coming from or going through British Columbia and $10 million (5 per cent) attributed to Alberta. Other major items included woodpulp, paper and paperboard, at $17.7 million, zinc and aluminum at $10 million, and telecommunications equipment at $1.1 million.

Data on commodity flows in Table 7 do not show trade in services, which are more difficult to estimate. Figures for Canadians travelling to Bali and to other points in Indonesia show that such tourism is still quite limited, especially when compared to Australians, Americans, and Europeans, but this also points to a promising opportunity for Canadian business as regards catering for tours, hotel construction, and providing "home-style" amenities preferred by some of these tourists at their destination. In taking advantage of such opportunities, Canadian businessmen have thus far been left behind by Japanese, American, Australian, and European promoters, but it remains an expanding field with much future potential. More important for Canada's current account surplus are the earnings from consultancy, banking, insurance, company management, and other service sectors, which have been a real "growth industry" for Canadians operating in Indonesia. A considerable amount of this has been funded and stimulated by CIDA, but Canadian service industry firms have had more than average success in responding to Indonesia's needs. It is convenient to consider this performance in connection with Canada-Indonesia investment and joint-venture operations.

Canada-Indonesia International Investment Relations

Total outlays from all Canadian firms participating in investment and joint-venture operations in Indonesia's development since the interregnum of 1967 must be in the billions of dollars. Most of this has involved exploration and venture capital and the supply of heavy equipment for oil, gas and other mineral development under joint-venture or product-sharing arrangements with government agencies. Very little data is available on these operations, and as a result there is not much information as to the extent of foreign involvement, profits repatriated, and the terms of agreement in effect. But Canadian firms such as Asamera Oil, Hudson's Bay Oil and Gas, Bawden Drilling and Trend Exploration are actively involved. Similar exceptional secrecy rules apply to foreign banking operations in Indonesia, where three Canadian banks--the Toronto Dominion Bank, the Bank of Montreal, and the Bank of Nova Scotia--are prominent, with others operating in Indonesia from offices in Singapore. These pivotal aspects of Indonesia's development can thus only be assessed qualitatively and in terms of broad industry-wide data.

All other foreign investments in Indonesia (except oil and gas, certain other resource contracts, and banking and insurance) are regulated and monitored by the Investment Co-ordinating Board, BKPM (Badan Koordinasi Penanaman Modal). This Board periodically issues lists of projects approved, showing combined dollar commitment by country and by major production sector. As shown in Table 8, Canada ranked third overall for the period 1967-82, with a total investment commitment of US $863 million (behind Japan and Hong Kong and ahead of the United States). This achievement has been widely cited as evidence of Canada's strong commitment as a partner in Indonesia's development, and as justification for the many efforts made by Canadian officials in promoting such involvement.

Pause for thought should be drawn, however, from the fact that this combined commitment represents only five Canadian projects out of a total of 811 approved over the period (Canada ranks 17th in terms of the number of projects approved). In fact, 98 per cent of this commitment ($850 million) apparently represents a single project, that of Inco's Sulawesi mining venture, dating from 1976. Even more sobering is the reflection that this project is currently operating at only 40 per cent capacity due to depressed nickel prices and local production problems and has yet to show a profit after six years. Inco is seeking to sell off some of its 98 per cent equity to the Indonesian government or to its Japanese partners, thus far without success.

While Inco represents Canada's largest commercial venture in Indonesia, the "Maple-leaf flagship of profitability" and long-term commitment must be Bata Shoes, the world's largest shoe manufacturer, which produces six million pairs of shoes a year for the local market at its two factories in Jakarta and Medan, and employs some 2000 Indonesians. It was, however, founded in 1931 as a Dutch company when Bata was still headquartered in Czechoslovakia, and it maintained its special status by being one of the first companies to introduce Indonesian participation in ownership and management, long before it was required by the government to do so. It recently obtained approval for a Rp 1.2 billion (one US dollar = 995.00 Rupiah, December 1983) share issue on the Jakarta stock exchange, being one of only 21 foreign companies that have been authorized to float local shares. With the proceeds of this share issue, Bata plans to expand annual production to 10 million pairs of shoes by 1985. Only about a dozen other Canadian companies (including Alcan, Bombardier, and MCL Consultants) are conspicuously active in Indonesia, the largest number being consulting firms. Most have little or no equity involvement and are not registered as joint venture operations.[9]

Since 1974, it has been mandatory for all foreign investors in Indonesia to form joint ventures, with at least 20 per cent of the equity owned initially by pribumi or indigenous, non-Chinese nationals, and with the participation expanded to 51 per cent or more within ten years. Because of the difficulty of finding suitable joint-venture partners, investment banks can be used as interim partners so long as the shares issued are disposed of to pribumi partners within five years. In practice, many foreign companies have partners who are members of the military, the bureaucracy, or other well-connected persons who are more useful as expediters than as managers or production planners. There is no restriction against having ethnic Chinese as joint partners, but equity held by them does not count as part of the pribumi-owned requirement.

This illustrates that Indonesia, like most newly independent countries, is simply not interested in foreign ownership and control of its means of production. Foreign investment is valued for the foreign exchange and venture capital it makes available, the advanced technology and skills it can command, and the income it can produce and share with Indonesia in the form of taxes, royalties, wages, outlays accruing to local suppliers, and profit dividends. It is no longer appropriate for potential investors to expect to operate extra-territorially with the same autonomy and degree of freedom that they enjoy at home. This is especially the case for foreign investors in LDCs with long and bitter memories of what they believe to have been outrageous exploitation under the yoke of colonial or neo-colonial oppression. This axiomatic fact is lost sight of, however, if businessmen operate under the mythology of 19th century "free competition, free trade, and laissez-faire" ideals.

Canada's Industrial Co-operation Program (ICP), a component within CIDA, is aimed primarily at facilitating joint-venture operations in less-developed countries by small to medium-sized Canadian companies. "Starter study" grants of up to $10,000 are made for liaison visits to look at prospects for investment, joint ventures, licensing agreements, co-production arrangements, management contracts and technical assistance with counterpart firms. Further grants of up to $100,000 are available for "viability studies", covering travel costs each way for principal and counterpart visits, plus 50 per cent of consultant fees and costs of product/process/material testing. Finally, project support of up to $250,000 is available for special training programs, professional services, personnel assistance, or to obtain equipment deemed necessary for project implementation, or to extend development impact into the host country. Grants of $250,000 can also be utilized as a Canadian project preparation facility (CPPF) to enable firms to bid more effectively on international tenders, to test and adapt technology for transfer to developing countries, or to facilitate technical assistance or information networks.

Although financial assistance for starter and viability studies was first introduced in 1971, the project support component did not begin until 1979 and CPPF was not implemented until 1981. Total disbursements under the program have grown accordingly in recent years from $3.95 million in 1979-80, to $7.21 million in 1980-81, $14.16 million in 1981-82, and $15.98 million in 1982-83. Higher appropriations could have been disbursed had the program been fully utilized.

CIDA administrators emphasize that ICP is much smaller and has not been fully operational for as long as PEMD. ICP projects also may require a much longer gestation period before benefits can be fairly assessed. Results have been disappointing, even to the administrators. In-coming requests are now screened by CIDA, and Canadian companies are selected to negotiate with potential off-shore partners. This has elicited criticism of "special favours" and of bureaucratic intervention in deciding what types of business should be promoted, rather than leaving this to private enterprise and competition to determine. Nonetheless, it is clear that inducing Canadian businessmen--especially small and medium-sized concerns with little overseas experience--to get involved in joint ventures abroad is much more difficult than encouraging them to expand their exports from home-based plants. ICP and PEMD now also co-operate in promoting business contact through periodic CANEX fairs overseas. These have received a mixed press, including the criticism that Canadian technology exhibited is often relatively backward in comparison with ASEAN "best practices" and yet may not be sufficiently labour-intensive for lower-wage countries. Recognition of and adaption to the diversity of overseas requirements and operating conditions still seem to limit Canadian perceptions of commercial possibilities abroad.

In the case of Indonesia, an evaluation study of ICP in July 1982 found that of 25 approvals for starter and viability studies none had actually resulted in the establishment of a joint-venture operation. In addition, three CPPF grants had been made where bids later proved to be unsuccessful, and 14 other grants had been made to facilitiate institutional linkages, information exchange, industrial surveys and technical assistance schemes. By July 1983, a cumulative total of 48 approved applications relating to Indonesia had received commitments totalling $2.4 million and actual disbursements $1.9 million, yet still it was difficult to find examples of "success stories" that administrators could cite in the Indonesian context. Businessmen interviewed, however, found little fault with the program itself: most said that doing business in Indonesia was much more complex and difficult than had been expected. It required frequent visits and close contacts with the bureaucratic, military and political hierarchy to be successful. Appropriate and reliable counterparts were hard to find and government rules and regulations were excessive and subject to change abruptly and unreasonably. The need to adjust to the many and often exotic conditions in working arrangements, labour relations, material supply, marketing, local financing and accounting, and a myriad of other paperwork was often overwhelming and made joint ventures seem simply unfeasible for many small and medium-sized firms.

Small and medium-sized firms cannot attract the same influential joint-venture partners as large multinationals and therefore cannot get as much discretionary exemption from the plethora of regulations to which foreign firms are subject. These include title restrictions to land and limitations in certain types of utilization of land and other resources that are reserved for Indonesian nationals. Certain employment categories (such as accountants) are reserved for Indonesians, there are limitations on the dismissal of local employees, and pressures are exerted to utilize local suppliers and sub-contractors in certain instances.[10] Extensive, and at times seemingly arbitrary, reporting rules and licensing requirements affect smaller firms in particular, leaving them open to interference and petty corruption. Obtaining and renewing permits of domicile for expatriate staff, as well as tax and other regulations, can also be vexatious for small firms and individuals doing business in Indonesia, though visa requirements for short visits have recently been simplified. Such considerations undoubtedly help to explain why so many Canadian investment proposals and liaison visits funded under ICP have failed to result in actual projects.

Multinational corporations are favoured, not only by Indonesian government agencies and potential joint-venture partners, but also by Canadian government incentive programs, which give a de facto preference to larger ventures. Foreign investment proposals submitted to BKPM, for example, will only be considered if they are in excess of US $1 million (at least half of which, and in practice much more, must be provided up front by the overseas partner). Especially where investment missions are conducted at a high ministerial level and concessions can be made on an individual contract basis, the largest firms and conglomerates are able to make the best deals. Increasingly, a consortia approach has become common, involving several large corporations, international banks, and consulting firms and closely supported by a number of government agencies on both sides of the negotiating table. This in part reflects what has been called Indonesia's "official fixation with giantism", which may be appropriate in attempts to centrally direct an immense country and in such priority fields as resource exploitation, massive transmigration schemes, and nationwide programs of road-building, power supply, seed-fertilizer, irrigation, rice storage and public administration extension. But this approach loses sight of a wide range of smaller joint-venture operations, which might be needlessly discouraged.[11]

Every six months or so, BKPM issues fairly specific lists of "priority" and "preferred" sectors it considers appropriate for foreign investment and to which tax reductions and some infrastructure subsidy can be applied. The Foreign Investment Priority (DSP) list issued for May 1982, for example, gives preliminary information on 300 specific ventures across a series of 50 "top priority" sectors. New projects highlighted were: the construction and operation of a toll road and bridge in a joint venture with state-owned Jasa Marga, a dissolving pulp and rayon plant in South Sumatra, the manufacture of television broadcast and video data-communications equipment, an export-oriented fruit and vegetable canning plant, and the manufacture of agricultural tractors. Five other manufacturing projects upgraded to top priority status involved the production of electric motors, switchboard equipment, caprolactam, boilers, motor cycle engine castings, aluminum rods and castings, lead ingots and zinc ingots. These top priority projects qualify for a two-year tax exemption, extendable for an additional four years if certain other conditions are fulfilled. A broader range of lower priority projects and sectors may be granted a tax allowance of up to 20 per cent of the investor's total capital outlay, and allowance can be made for accelerated depreciation of fixed assets. Additional priority projects include other non-ferrous metal plants, several types of pharmaceutical facilities, pulp and paper and newprint mills, petrochemical factories and a range of oil and gas support services.[12] There is clearly a close correspondence between priority sectors and traditional Canadian fields of specialization (and hitherto export staples in Canada-Indonesia trade and CIDA-promoted economic assistance).

Aggregate figures for foreign investment, between 1967 and 1982 are shown in Table 9. Not included are the oil and gas ventures managed under production-sharing arrangements and contracts of work with Pertamina, the state oil company. Project approval and investment commitment also need not indicate actual investment outlay, and such aggregations over time and for all types of foreign investor do not necessarily indicate relative significance for current or future foreign investment. What the data does show is the dominance of resource-based, capital intensive sectors, and the relatively small investment in agriculture, manufacturing, and service-oriented industries. Chemicals, mining, basic metals, non-ferrous metals, and metal products together account for 64 per cent of the total commitment; with forestry this becomes 70 per cent. The only exception is the large number of relatively small textile projects, which for the most part represent Hong Kong or other Asian investments.

The window of opportunity for foreign investment in Indonesia is thus relatively narrow, and liable to change shape intermittently as new regulations are imposed and new priorities are announced. It also requires exceptional acumen and agility to cope with what is widely revered as the "legendary, always inscrutable, and sometimes devious Asian business ethic", which makes most Canadians feel like innocents abroad. It is likely that South Korea and especially Singapore will follow Japan and Hong Kong in crusades of "little dragon" investment in Indonesia and elsewhere in Asia, thereby further narrowing the readily accessible arena to fields where Canadian firms can command a special expertise or market prospect, or can provide other special elements in a package deal. Tripartite joint ventures might include a Canadian presence, but most firms would probably find this too forbidding to contemplate, although considerable experience and range of contacts exist to foster this in Canada's own "little dragon" business communities on the West coast and in other cities.

Many Canadian and other multinational firms with interests in Indonesia have preferred to base their regional operations in Hong Kong or Singapore, which offer "more Westernized" facilities, and which generally have seemed more straightforward and predictable in their rules and regulations. Hong Kong's special status may soon disappear, however, and Singapore has been discouraging the focus on "cheap labour intensive processing industries", setting its sights instead on a steep trajectory of industrial and occupational skills in an effort to become the "high tech" and financial hub of ASEAN. Singapore is supporting Indonesia in building an extensive industrial estate and free port zone on Batan Island, just 23 km southeast of Singapore, partly to receive the exodus. This provides a striking example of the Greater East Asian Integrated Product Cycle, which will be discussed in the conclusion. Perhaps closer economic integration and pan-ASEAN joint ventures are the way of the future, perhaps not. It all depends on how Indonesia sees its national autonomy and special destiny being affected in the process. It is thus valuable to look more closely at Indonesia's strategy options and priorities for the years ahead.

Strategy Alternatives and Priorities in Indonesia's Development

Background Considerations: From Sukarno to Suharto

Indonesia inherited an open, dualistic, primary export economy from its centuries of colonial rule, and development strategy since independence can be broadly catergorized as having been based

- partly on a continuation of primary export-led growth, but seeking to diversify the commodity composition and to transfer ownership and control to indigenous rather than foreign operators, and
- partly on a reaction to foreign trade, aid, and investment dependency, seeking to reduce economic dualism, to build up and integrate the indigenous economy, and especially to promote industrialization.

Convinced that neo-colonialism was still operating to exploit Indonesia's continuing primary producer status, President Sukarno increasingly emphasized through the 1950s and 1960s an inward-looking ideology, rejecting foreign aid and investment, and striving for local self-reliance. However, no clear strategy for national economic integration or locally balanced growth was formulated, and woefully inadequate provision was made to improve social overhead, to promote local investment and entrepreneurship, to develop skills, and to help guide the reorientation of production to better serve local needs and capabilities. Economic isolation thus meant economic stagnation, and the first priority of President Suharto's New Order administration after 1967 was to revive the engines of growth that foreign aid, trade, and investment could provide for Indonesia.

Results far surpassed expectations, with GNP growth rates above 7 per cent recorded throughout the 1970s, assisted though this was by a tenfold increase in petroleum prices, courtesy of OPEC. Oil and gas exports alone provided 60 per cent of foreign-exchange earnings and 67 per cent of government revenues, both of which were increasing at even faster rates than the GNP. Much of the bonanza of earnings was recycled into further resource development and into the support of elevated lifestyles among the elite, and thus economic dualism has increased in terms of income and social polarization.

There is evidence that the bottom 40 per cent or so of Indonesia's citizens may have been made no better off as a result of this accelerated growth, and several groups have been impoverished by displacement effects and ecological depletion.[13] But there has also been some spectacular improvements in transport and communications, in administrative outreach and regional development of infrastructure, in education and other social services, and in increased commodity flows and movement of people within the country. A major rice intensification program has transformed Indonesia from being (for several years) the world's largest importer of rice to a country that is nearly self-sufficient vis-à-vis this crop. A major transmigration program has moved thousands of people (and plans to move millions) from the over-crowded Java to Outer Island locations; this resettlement will have far-reaching results. There have also been major efforts to diversify both export production and manufacturing activities throughout the country, and to help pribumi traders and producers assume a more controlling role in broad sectors of the economy.

The apparent reversal of Sukarnoist policies by the New Order government is often simplistically interpreted as a return to an essentially capitalistic, free enterprise, and open economy. This is a misconception, and anyone doing business in Indonesia knows that it remains highly regulated. (Indonesia has been described as the second most bureaucratic state in Asia, after China.) It is not possible to pinpoint or define Indonesia's mixed economy on a hypothetical spectrum between "free market" and "planned economy", but there is an ingrained tendency toward interventionism going far back into colonial times to which the government must remain responsive, a tendancy that has been buttressed by popular--and religious--anti-capitalist and anti-Western sentiments. The 1945 Constitution prescribes that the economy must be organized on joint-venture or co-operative (usaha bersama) principles, that production relating to basic needs be controlled by the state, and that natural resources be controlled by the state for the benefit of the people. The national ideology of Pancasila, enunciated by Sukarno, but continually and emphatically endorsed by Suharto, also decrees that all behaviour and personal and public objectives be guided and assessed by the five higher principles of belief in God, nationalism, humanitarianism, participatory democracy, and social justice.[14] Unfettered economic calculus is often deplored as uncouth and offensive.

Thus, while Suharto's New Order has consciously created an "opportunistic society" and one committed to export-led growth and a partners-in-development approach to large-scale foreign multinational business, it cannot allow inequalities, ostentatious Western lifestyles, foreign influence, or abuse of authority to get out of hand. Repelita III elevated "eight socio-economic objectives" (provision for basic needs, universal health and education, reduced income inequality, fuller employment, small business promotion, better prospects for youth and women, more even regional development, and equality in human rights before the law) to equal status with concern for "economic growth" and "political stability"--comprising "the development trilogy" of national objectives. We might expect that the state will become more, rather than less, interventionist in the years ahead, as it strives to fulfil these goals and to respond to the aspirations and demands to which they will inevitably give rise.

Several major World Bank and other technical assistance projects exist to upgrade administrative standards and capabilities, especially at the various levels concerned with regional development throughout the country.[15] There are generally five or six levels of officialdom involved in administering various elements in government plans and foreign assistance projects: below BAPPENAS (the Central planning agency) and the various central departments, there are propinsi (provincial), kabupaten (district), kecamatan (sub-district), and desa (village or community) levels, all with their own bureaucratic structures and many with overlapping responsibilities. While streamlining from the centre is likely to be improved when the new training programs and pilot project techniques become generalized, it is just as likely that the extent of government intervention will be increased instead of some of the current dead wood being cut away. The campaign against petty official corruption and abuse of authority will also likely reduce this source of aggravation, though the overall tithing of economic activities seems likely to remain heavy, even if it is administered on a more systematic and predictable basis.

Short-term Considerations: Surviving the 1980s

It is now clear that conditions for the international economy in the 1980s will provide a dramatic contrast to those prevailing in the 1970s. The decade of OPEC surpluses, Eurodollar recycling, mega-projects and rampant inflation has been replaced by a decade of tight credit, financial crises, austerity and sluggish economic circulation. Beyond the unending and inevitable political chorus announcing that recovery is on the way, a growing number of experts argue that the whole decade will be tough and depressing.

From Indonesia's viewpoint, the "end of the bonanza" at least temporarily involves the postponement of scores of development projects. Many would argue that a major reorientation of development priorities is called for, which might be reflected in Repelita IV (Indonesia's Fourth Five-Year Plan, 1984-89). No longer can planners seek to solve economic and social problems by throwing money at them. It will not be so easy to borrow without limitation against anticipated future surpluses from accelerated resource development and export. Indonesia's development will now need to be grounded more broadly on indigenous sources of finance and engines of growth, and government outlays will need to be deliberated in a framework of much more constrained and carefully calculated choice.

The slump in oil prices and the new OPEC-imposed quotas, for example, have already cut this mainstay of foreign exchange receipts by 24 per cent for 1982-83, to US $12.5 billion (which represents about 80 per cent of Indonesia's export earnings). Non-oil exports have made things worse, with an earnings drop of 30 per cent due to reduced sales and lower prices. The result is an overall deficit of US $5.5 billion on current accounts for 1982, compared to a 1980 surplus of US $2.9 billion. GNP growth has also slumped, from 7.6 per cent in 1981 to 2.3 per cent in 1982 (after allowing for inflation), and is expected to be even lower in 1983. Oil receipts, which account for over 70 per cent of government revenues, fell by 5 per cent in 1982-83 to Rp 8.2 trillion, despite efforts to raise tax and official dividend shares. Budgeted current government expenditures are being held steady in nominal terms (though cut back in real terms) this fiscal year, with total outlays, including capital spending, only allowed to rise 6 per cent, which is well below the expected inflation rate. This has led to the shelving of more than 50 major capital projects worth over $20 million. In addition, urgent presidential decrees have been issued to all departments, instructing them to use local suppliers and contractors wherever possible, to conserve foreign exchange, and to endeavour to search for more labour-intensive (job creating) projects and technologies.

Together with a whole range of other austerity measures, this has clearly altered the conditions for foreign firms doing business in Indonesia and dampens the prospects for expanding Canadian trade and joint-venture operations there. Also, counter-trade requirements are now in effect for international suppliers on government contracts, and it is very possible that other types of import and foreign-exchange restrictions may come into effect. Devaluation of the rupiah (from US $1 = Rp 703 to US $1 = Rp 970 as of 30 March 1983) also makes imports and foreign borrowing more expensive at the present time and reduces the dollar value of expatriated profits. Such disincentives will tend to be reduced as domestic inflation accelerates (for example, half of the exchange rate effect of the previous devaluation in November 1978 was offset by domestic inflation within a year), but the additional uncertainty that inflation produces can also have disincentive effects upon trade and investment. Government efforts to retard inflation through fiscal policy and price controls will to some extent be counteracted by the massive dismantling of its subsidy programs on food, fertilizer, kerosene, gasoline, and other commodity subsidies, made necessary by World Bank and other external pressure and by its internal fiscal realities. Inflation can also be greatly affected by the uncertainty of local harvests and by other exogenous influences on various critical prices.

Anticipation of the devaluation in 1978 caused a capital flight, reducing Indonesia's official foreign exchange reserves in the year preceding it from US $6.4 billion to US $3.1 billion, and reducing net foreign assets of the banking system from US $11.2 billion to US $6.7 billion. Some of this will have returned by now, but the climate of uncertainty in international finance is likely to make it increasingly difficult for debtor nations to find accommodation at favourable rates in the years ahead. Indonesia's recent reclassification by the World Bank as a "middle income country" also makes it ineligible to borrow on the most concessional terms, so that debt recycling will increase the interest burden that it will have to carry.

The World Bank predicts that Indonesia's foreign exchange shortfall will total about US $21 billion over the 1983-86 fiscal periods. This figure is premised on a slight improvement in oil prices, an expansion in oil quotas, and a considerable improvement in non-oil export earnings; it is thus a relatively optimistic forecast. It is expected that $6 billion of this deficit can be met from official reserves or by short-term borrowing, and that the remaining $15 billion ($5 billion a year over the three fiscal years being considered) might be forthcoming in foreign economic assistance, mainly as medium- and long-term loans.

Indonesia's credit rating remains high, especially when compared to other debtor nations such as Brazil, Mexico or the Philippines, and this was attested by the record US $2.2 billion combined commitment in foreign aid for 1983-84 that was agreed to at the June 1983 meeting of IGGI. As shown in Table 2, however, the rising annual commitments and mounting total debt outstanding have provided only meagre and sharply declining net financial transfers to Indonesia in recent years, primarily because of the high interest rates at which debts have had to be renegotiated. Even more effort will thus be needed to bridge the World Bank's forecast of Indonesia's shortfall. Total official indebtedness (excluding "private" loans negotiated) is expected to exceed $30 billion by 1985, raising its ratio of expected export earnings from its present 22 per cent to around 26 per cent (and even higher if private indebtedness is included).[16] If export growth remains sluggish and global interest rates return to high levels, the debt burden could become very onerous and Indonesia's credit rating might thus suffer accordingly.

In summary, the short-term prognosis would seem to be that Indonesia will be looking for increased bilateral and multilateral aid, more short-term credit from the banking system, and more private capital inflow, especially to assist export-oriented projects and priority social and economic infrastructure. It will be less receptive to increased imports (except as "free" tied aid) and will bargain hard for quid pro quo and preferential treatment for its less saleable exports. It will prefer capital inflow that is "fluid" to that which is tied to specific projects or which seeks to promote non-priority production (especially capital that competes with local producers). The tendency toward "linkage and packaging" in foreign economic negotiations will very likely become more sharp and insistent, and only the larger multinationals will have enough influence to gain dispensation from the increasingly stringent conditions imposed on foreign business operations.

Longer-Term Considerations: Toward the Year 2000 and Beyond

While foreign-exchange considerations and the government's need to rely on revenues tapped from primary resource extraction will continue to make Indonesia an "export economy" for the forseeable future, the attention of the World Bank and other appraisers will focus on the government's ability to ignite and/or nurture development within the indigenous economy. The challenge is to stimulate more "inward-looking" or "locally balanced" development, without relapsing into the economic stagnation of the Sukarno era. The problem for economic planners is to harness the export-led engine of growth and the self-sustaining mechanism of a more fully articulated domestic economy. If this can be accomplished, President Suharto will truly be immortalized as the "Father of Development", a title given him when he assumed his third, and probably final, term of office in 1983.

Achievements thus far--in opening up localities through improved transportation and communication systems, in rice intensification through new seed-fertilizer and irrigation technology, and in efforts to promote pribumi enterprise in trade and manufacturing--have had only partial success in catalysing and co-ordinating what used to be lightly described as the "take-off into self-sustained growth". It is now realized that this will be a much more laborious, and perhaps fortuitous process. There is in fact no economic model or theory to provide a reliable blueprint: it is now apparent that each individual LDC occupies a particular and substantially unique niche on the development frontier, and is blazing its own trail into the unknown through "learning-by-doing". This especially applies to Indonesia, with its unique combination of high population density and engrained poverty in Java (the most densely inhabited area of comparable size in the world), and the extensive but largely uncharted resource wealth offshore and in the Outer Islands. It will require imagination, flexibility, and the ability to unleash all potential energies and domestic talents if the enterprise is to have any hope of success.

There has been substantial progress and learning-by-doing during the first three Repelitas under the New Order, inspired by the lessons learned from the previous regimes. Even negative experiences have their value in helping to avoid similar pitfalls in the future. On the positive side, Indonesia is clearly in a much better position to move toward more balanced and self-reliant economic growth than it ever was during the Sukarno era. The dramatically improved transportation and communications network, other basic infrastructure and administrative capabilities, and the improved primary education, health, and social facilities all provide a sturdier base for more effective economic integration and a more promising context for the articulation of development initiatives, whether these originate from government, from private commercial ventures, or from community-organized mutual assistance efforts. What needs to be discovered are more productive ways and means for these well-springs of initiative to operate and interact.

Reassessment of Indonesia's development strategy and potential must start with the human equation, recognizing not only its positive aspects--exceptional breadth and variety of culture, creative talent and social organization, which is this nation's greatest resource--but also the negative impact of rapid population growth, "the great denominator", on limited resources: the division of living space, arable land, and all other natural and man-made resources into smaller and smaller fragments, which leads to a situation that will be reversed only if ingenuity and innovation can develop new resources and devise new livelihoods at a faster pace.

The investment in almost universal primary education has begun to enhance the effectiveness of Indonesia's stock of "human capital", promising on-going and inter-generational improvements in productivity in a range of occupations. But a harder task lies ahead: the extension of secondary and vocational training opportunities and access to jobs to benefit a broader segment of the population. Also needed are more vigorous managerial talents, more effective business arrangements, and a more positive business-government environment and policy framework. More "people-oriented" and "system-oriented" innovations are also required to release and ignite the human potential inherent in Indonesia's huge population pool. New perspectives are called for, ones that are less concerned with relative shares in a "fortuitously-expanding" economy and more attentive to stimulating growth and to devising new development plans in order to increase economic prosperity.

On the Malthusian side of the equation, progress is also evident in the extension of family planning services, as well as infant care, health, and nutrition information dissemination under national programs and volunteer agency networks. The greater facility for internal migration (whether assisted or spontaneous, circular or permanent) has also helped to reduce demographic imbalance and to even out the subsistence pressure on the environment. Yet there has been a tendency, in both types of programs, to look for panaceas and also to claim "success" or dramatic results prematurely for internal or international political purposes. Claims that overall population growth was down to 1.8 per cent a year by 1980, as reported to the World Bank for example, had to be modified to 2.3 per cent or more. The fact that a smaller average family size was reported among the poorer segment of the population should have forewarned analysts that the finding might well be suspect and/or transient.[17] Unrecorded returns of migrants may also undermine claims of the total number of migrants resettled, especially as the five-year periods of subsistence and fertilizer support come to an end. It is now more generally thought that transmigration might help to slow down the increment of Java's population increase, but that reducing total pressure on rural subsistence will be secured only if and when more people can be successfully absorbed into off-farm and urban-industrial occupations. This brings us back to the need to identify and implement a new style of production strategy for Indonesia's future development.

The customary reliance on export-led growth, imported technology and management, and accelerated resource extraction is not only insufficient, but has created a substantial legacy of negative fallout with which future planning reorientation must contend.[18] This includes ecological fallout, including the often rapacious forestry and mining activity that occurred under the relatively unregulated circumstances of Repelitas I and II, resulting in land erosion and seepage, pollution and sedimentation of rivers, and negative impact upon catchment areas, water-tables, coastal waters, swamplands and fish hatcheries. Other ecological and human damage has been caused by the run-off of pesticides, herbicides, and fertilizers--killing fish and poisoning drinking water--and also through industrial effluent and atmospheric pollution from mineral, petrochemical, and other hazardous processing activities.

Further negative social fallout has resulted from dichotomous development and polarization, separating those fortunate enough to ride the escalator of ascending incomes from those who have been left behind. Substantial negative economic fallout has occurred through livelihood displacement, for example in rice harvesting and the cottage industry at village level as a result of land consolidation, greater commercialization of agriculture, and intensified competition from the urban unemployed now more able to move into rural areas in search of work. Exodus and transmigration have not provided sufficient alternative livelihoods to offset these displacement and impoverishment effects, and neither has the growth of urban manufacturing which often involves capital intensive and "inappropriate" techniques unnecessarily displacing jobs, handicraft skills, and small businesses. The urban drift of rural residents into "self-employment" niches in the "informal urban sector" (from day labourers and messengers to hawkers and pedicab operators to beggars and petty criminals) has continued to create "poverty ghettos", which are often more vulnerable and unhealthy environments than those left behind in the villages. And the most worrisome aspect is that this may be just the visible overflow from a more pervasive and intractable problem of "shared poverty" in the still-crowded rural areas.

It is difficult to get a clear fix on the size and dimensions of the problem and to weigh the negative aspects against the potential new livelihood opportunities being created by the government's modernization programs, especially as these are often expected to have a preliminary dislocating and unequalizing phase prior to generating a broader distribution of benefits. Since the optimistic golden decade of development economics in the 1960s, faith in trickle-down, spillover, multiplier, accelerator, demonstration, and similar "spread effects" has also been substantially eroded, along with confidence in the "take-off" analogy. Most LDCs have shifted towards more pragmatic "poverty-relief" and "job creation" strategies, at least as interim measures, if not as permanent safety nets or palliatives to the polarizing effects of the rush to modernization. Indonesia's pursuit of the "eight channels of social-economic equality" under Repelita III is an example of such concerns. The problem, under the new austerity, will be that free universal social programs, basic needs subsidies, and expenditure largesse in support of local mosques and other "non-productive" projects, will be harder to justify and maintain. There will be less of a windfall to distribute, and the indigenous sector can no longer be regarded as the passive "sleeping partner" in economic dualism: somehow it must be galvanized into becoming more self-supporting and self-improving.

Whether such igniting of the indigenous engines of development is judged to require more or less government intervention is primarily a matter of ideological predilection, especially in the absence of clear comparative data on alternative organizational arrangements by various types of project. But finding new workable arrangements will clearly involve much trial and error, and a pragmatic experimental approach has much to offer in this regard, given the uncertainty and precursory nature of the endeavour. If private initiative and mutual self-help can "deliver the goods", it is better to conserve the over-extended government resources for these areas where they have demonstrably greater efficiency or an essential political role. A presumption in favour of individuals knowing best their own needs and of local markets and participatory arrangements being able to effectively utilize resources is a fundamental precept of the economist's creed--at least in the mainstream tradition from Adam Smith to Paul Samuelson. The question is how to unleash individual and self-help efforts in ways that conform to national priorities and how to identify which rules of the game are needed to regulate unacceptable predatory conduct, antisocial polarization, and other negative fall-out.

Indonesia has thus embarked on a transition from an essentially "neo-colonial" strategy (based upon primary export-led growth and high dependence upon foreign investment, management, consultancy, concessional borrowing, and technical assistance) to a more "self-reliant" and "balanced growth" strategy (involving substantial diversification of its export base and its structure of production, greater Indonesianization of its financial, entrepreneurial, and professional activities, more emphasis on manufacturing development and production for the local market, and the utilization of a more "appropriate" technology and organization, with closer attention to social and cultural ramifications and policies better attuned to its unique environmental, economic, social, and political circumstances). Simply to spell out the transition in one sentence emphasises the formidable task involved. Indonesia will also be called upon to be more self-reliant by virtue of being promoted to "middle income country" status on the World Bank's assistance list.

Export-led growth is generally enunciated as a "small country" strategy, for countries that are able to expand sales in world markets without substantially depressing prices, and countries that have to export to obtain the wide range of goods not producible from their narrow domestic resource base. An alternative export-led growth model that is normally applied to larger country situations is "bonanza development", where a sudden rush of revenues from a new resource discovery or a windfall price hike (such as arranged by OPEC) short-circuits the need for a laborious and steady growth in domestic savings and enables investment outlays and general economic circulation to accelerate quickly, raising the whole economy with a "big push" effect, thereafter allowing a higher level of endogenous growth to be sustained.

Indonesia is seeking to apply the second model (in the footsteps of Canada, from whence came the theory of "staple-led growth", using a sequence of resource-intensive primary exports to generate the money needed for more balanced industrial production). Indonesia cannot hope to substantially raise the incomes of its 150 million citizens directly by "bonanza development". Government oil and gas revenues for 1982, for example, represented only about US $60 per capita, even if it were all available for distribution. The country must therefore find other means to sustain long-term income improvement and to generate sufficient productive employment for its expanding population.

Export diversification strategies enable a series of engines to work at length, but most commodities in which Indonesia can readily expand production face extremely inelastic price and income demand (limited absorbtive capacity) on world markets, especially as Indonesia has the potential to be such a large producer of any one of them. As the great-grandfather of export economies, Indonesia has a long string of staples coming down over the centuries, from the spices and indigo that attracted Columbus, through coffee, sugar, tobacco, tea, cinchona, rubber, oil palm, copra, pepper, maize, casava, to present-day oil, LNG (liquefied natural gas), bauxite, tin, lumber, fish, and manioc.[19] All these "bonanzas" (albeit mostly under colonial domination) did little or nothing to uplift the average levels of living for the vast majority of Indonesians. While not belittling the crucial contribution obtained from export-led growth and primary export diversification (such as in transmigration settlements and nucleus-estate development), it is perhaps fair to insist, after 400 years of experience in this regard, that the onus of proof must lie with those advocating more primary export-led growth as the panacea for Indonesia to show how the poorest 40 to 60 per cent of Indonesians will be made better off as a result.

Economic development has to mean more than the replication of jobs at or around subsistence levels, even over a broader range of occupational categories. It involves sustained increases in per capita incomes, or at least the expectation that inter-generational comparisons will find generally higher levels of well-being over time. The only hope for this lies in increased productivity as a widespread and steadily ongoing phenomenon. We are not sure that Canada is presently secure in this perspective, and we are certainly not sure that Indonesia (and most other LDCs) can be said to be embarked on such a trajectory. Development is also not the same as "modernization", especially when this has such serious displacement effects (or "substitution" rather than "income" effects in economic parlance). Furthermore, it is not the same as GNP growth, as modernization is highly concentrated in upper income strata and in relatively small, urban-industrial and export enclaves and does not have commensurate effects throughout the country and society as a whole.

At its simplest, the requirement for economic development is industrialization, but of a kind that "enhances and abridges labour" as Adam Smith described it, not of a kind that displaces labour for the most part. It requires "appropriate" industrialization in all sectors of the economy, in agriculture, in utilization of other resources for local livelihood enhancement, in manufacturing, in services, and in provision for basic social overhead and social amenities. The trick is to find means to use labour more effectively and to absorb the increasing output without squeezing out large sectors of other local employment and sources of cash income to lay claim to some of that output.

Inevitably, there will be some substitution and displacement effects, but every effort should be made to ensure that new livelihood opportunities become available to absorb the "redundant" people simultaneously and systematically without causing widespread destitution.

Most of these jobs must then also offer prospects for steady enhancement of productivity--value of output per worker--after a possibly short transition period for reorientation, occupational and social adjustment, skill upgrading and on-the-job learning by doing. Such smooth and balanced manpower planning is beyond the capabilities of even the best government-run employment offices in industrial countries, so it is likely to be beyond the reach of most LDCs, who have more entrenched unemployment and underemployment problems and less information and training facilities at their disposal. The government can do much to improve "the context of opportunity" and to remove obstacles and inhibitions in the system, but it cannot generally expect to direct the whole process from above without the risk of paralysing bureaucratic procedures and enervating the obstructionism of private self-help efforts.

In seeking to promote indigenous industrialization, Indonesia has an advantage over most other LDCs owing to its large internal market (albeit the present low per capita expenditures) and its long tradition of craftsman and manufacturing aptitudes, which could greatly facilitate movement into a broad range of "intermediate technology" and "middle-income consumer products". As development proceeds, there will also be expanding demands for a range of producer goods, components, and material supply, in the construction industry for example, and for equipment maintenance, installation, and repair services. Linkage effects, technological spill over, demonstration and agglomeration effects require a diversified and expanding local network of manufacturing and service activities to mutually reinforce each other, to encourage labour training, and to justify an upgrading and extension of social overhead facilities. This greater articulation of indigenous production can also occur alongside, in conjunction with, and not necessarily at the expense of, export-led growth. There will be some import substitution, but not necessarily a cut-back in total imports. There will be some Indonesianization in control of production, but not necessarily a decline in total foreign investment and borrowing. There will also be different requirements in foreign economic assistance, but it will be some time before Indonesian self-reliance obviates the need for this entirely. What will be involved is a series of general structural adjustments within categories, rather than a complete change of strategy as regards foreign involvement, including the range of Canada-Indonesia economic relations.

Indonesia cannot, of course, produce "everything at once" with regard to its manufacturing needs--indeed neither can Canada, the United States, or Japan--and trade will continue to occur even in relatively standardized industries that the government has not pinpointed as priority sectors for pribumi or other local development. As with Canada, Indonesia can choose to select the manufacturing lines that it thinks its people will like to work in and to subsidize or protect these to the extent necessary to make them viable and profitable. Insofar as such "forced industrialization" faces lower-cost competition from abroad, domestic consumers will be "taxed" by the higher prices sustained to benefit particular local producer interests. Such situations have been "justified" or rationalized on the basis of infant industry, national security, industrial training, demonstration and spread effect, and a plethora of other "positive externality" arguments. Concrete examples are the subsidizing of fertilizer production to force-supply local farmers, the propping-up of domestic aircraft production on grounds of national prestige, the requirement that equipment be suited to allegedly unique transportation needs, and the encouragement of university enrolment in a range of high-tech fields. There is unlimited scope for ingenuity, at least in this aspect of industrial enterprise, both in Indonesia and in Canada--and in virtually every other country. Taking the wrong decisions now in industrial development can lead to some awkward situations later and will require at some point even more painful and wrenching structural adjustment to extricate oneself.

The fact that Indonesia is such a late-industrializer, and is in such close proximity to so many aggressively successful newly industrialized countries (NICs) such as Singapore, Malaysia, and South Korea, makes it almost inevitable that it will have to follow a heavily "inward-looking strategy" in its attempts to secure and extend its manufacturing base. Comparative-advantage pressure to specialize (as with all optimal allocation theories) operates best or only under full employment conditions, as rising real wages in otherwise competing economies are required to persuade some of the population to seek more profitable occupations and to vacate the field in more labour-intensive industries. Under conditions of chronic unemployment and depressed wages, and with excess capacity and sluggish demand for most products, there is no incentive to upgrade technology and move into new lines of production. Increasing protectionism can even induce some "retrograde" steps, moving back into previously abandoned "sweat-shop" or other "menial" industries. There is no "pull effect" at work, only a "push effect" from workers and politicans desperate to create more jobs in their areas. Even Canada is loath to relax trade restrictions on the import of tailored cotton shirts from Indonesia, fearing political backlash from Quebec and elsewhere. Every nation seems to be producing "more shirts than their citizens can wear" and to be reluctant to move into less obvious and less excessively competitive lines of work. Similar considerations apply to other ease-of-access industries into which Indonesia might readily expand.

Value-added process manufacturing in some of its basic primary exports is another avenue to industrialization, and one where Indonesia might feel it has an evident and automatic comparative advantage. But here again, it is often not as straightforward as it may seem. The one big "success story", which is sometimes cited as a model, is the recent transformation in Indonesia's lumber industry, which was brought about mainly through the simple expedient of banning raw log exports. Table 10 summarizes the volumes of wood products exported globally by Indonesia in recent years, with total earnings accruing therefrom. Can this significant structural tranformation be judged to be an enormous success? Apparently not yet, according to revenue figures, even though Indonesia sought to be the largest foreign supplier of plywood to the US market in 1982/83.

The challenge may be much greater with other potential value-added processing, where Indonesia may face a few large transnational buyers with scope for exercising considerable monopoly/monopsony power. This applies, for example, to a wide range of petrochemical and pharmaceutical plants, in which the Indonesian government appears to have placed high hopes for upgrading industrial structure, and for sharing in the wide mark-ups between raw material cost and final product price. Under engineering optimum scale, such industries are spectacularly capital-absorbing in plant, scientific staff, research and development (R&D), quality maintenance, advertising, and marketing outlays. Plant lay-out in many such chemical as well as mineral processing operations also needs to be geared to multi-product and multi-purpose utilization of potentially useful by-products if these are not to be thrown away as costly and often dangerous waste. Minerals also are often processed close to point of end-use to avoid costs of reheating, or to obtain high tolerance and alloy qualities required for particular uses. Many processed items also become more fragile, prone to damage, bulkier, more awkward, and costlier to transport than their raw components would have been. Tariff and non-tariff barriers around industrial countries are generally steeply slanted against processed--but in favour of less-processed--imports.

Importing firms and countries are also often able to turn reciprocal demand bargaining to their favour, threatening to cut off demand, or to switch to competing sources of supply (which are generally more numerous than points of accessible demand) or to restrict access to technology, shipping, information networks, credit, or longer-term contracts if the supplier does not agree to ship in the desired form. If a major buyer of bauxite or copper decides, for example, that it is more profitable or more convenient to process Indonesia's resources in Europe or New Guinea or South Korea, there may be few or no options (except the option of not exporting). Only in cases where processing is very labour-intensive (low-wage) or where there is much weight loss or durability gain involved--or where

Indonesia itself has monopoly/monopsony power--can a strong case be made for insisting on processing in the country of origin.[20] Many developing countries have invested millions of dollars in such "obvious" processing facilities. Sometimes, they built such facilities out of a conviction that their "industrial essence" was being leached away by resource-poor but capital-rich nations--only to find that the operations had to be perpetually subsidized.

One structural adjustment that will thus substantially affect both Indonesia's planners and their partners in development--and not only in the short term, but over the longer term as well--is the "obsession with giantism" and "straightforward" multi-million mega-projects will have to be toned down in favour of more complex investment allocation criteria. Huge mega-projects have reduced economic rationale once the basic infrastructure in resource access, transport, communications, power, and irrigation facilities have reached certain levels of adequacy. More diversified planning and economic assistance will be needed to keep such facilities operating and to make them productive.

In every aspect of planning, less obsession with social overhead capital (SOC) and more focus on directly productive activities (DPA) will be required, and this will determine whether Indonesia's industrialization becomes an economic advantage to her people. Further aid and joint-venture operations will be called for, not only in resource extraction and agribusiness, but also in efforts to underpin, upgrade, and enhance a wide array of manufacturing and service facilities. New opportunities for foreign business will appear in "people-oriented" construction (housing, clean water and sewage systems, hospitals and clinics, educational and training centres) instead of contracts to build vast highway, railway, communications, power supply, and irrigation networks.

It is not the lack of opportunity but the lack of initiative, energy, and imagination that will frustrate those who fail to remain active partners in Indonesia's changing development. How Canada might fare, both as a home base for such potential partners and in competition with rival suppliers around the Pacific Rim and beyond is the concluding topic of this report.

Indonesia as a Context of Opportunity: Challenges for Canada

Not only Indonesia, but all ASEAN countries, all developing countries, and all industrial countries have been undergoing problems of short-term financial stress and longer-term pressures for economic transformation or structural adjustment. Some societies and some economies seem to be better at such transition than others. The rank order of agility however seems neither immutable nor preordained, and history has unveiled some piquant surprises. Canada is currently very bad at adjusting, after a rather long history of extraordinary transition from one type of staple-led growth to another. Japan has recently been very good at metamorphosis, after centuries of rigid structural stagnation under Tokugawa feudalism up until the Meiji era began in 1868. Great Britain, the home of the global industrial revolution, is now seen as the epitome of what is often called "the English disease" of chronic lethargy and technological antediluvianism. There evidently are some complex influences at work in determining adaptability.

The "Japanese model" of rapid industrial transition has in recent decades been followed with alacrity by the "four little dragons", as the East Asian NICs--Taiwan, South Korea, Hong Kong and Singapore--have been called.[21] Together with their economic mentor, they are the prime movers in what can be called the Greater East Asian Integrated Product Cycle. This is a special case of the more general shifts in industrial specialization, as factor prices and technological breakthroughs dictate new comparative advantages to industrial trading partners. Japan is thus moving rapidly into "high tech" and super-capital-intensive fields, vacating the intermediate strata (such as automobile manufacture) as South Korea is nipping at its heels. The latter meanwhile vacates middle-level, capital-intensive and more standardized fields (such as consumer appliances), which go to the Philippines and Malaysia, who in turn start to vacate even more labour-intensive and stable-technology sectors (such as textiles), which Thailand and Indonesia can then enter and compete in internationally by virtue of their considerably lower wage levels for unskilled labour. Japan, at the same time, is exporting its heavy transformers and telecommunications equipment to all levels below it, including Indonesia and Thailand, from whom it imports mostly raw materials plus some very labour-intensive processes for which it still has need.

This "convenient arrangement" may be reminiscent of what the Japanese were trying to put in place between 1940 and 1945--the Greater East Asian Co-Prosperity Sphere--and reminders of what this entailed for neighbouring countries may be the strongest obstacle to its full realization. But "the imperatives of the market" and the demonstrable gains from trade and complementary specialization are making it happen to a significant extent nevertheless. The technological ascent in recent years has been such that Indonesia is no longer necessarily relegated to a "hewer of logs and a planter of rice" in the system, but can expect its share of labour-intensive manufacturing as well.[22] This may or may not result in higher national average real incomes, depending on whether Indonesia can keep manufacturing and general productivity sufficiently ahead of Bangladesh and India to justify higher real wages in marginal productivity terms. Many other "labour surplus" countries will be pursuing Indonesia in the lowest category of low-skill, labour-intensive industries, so that success will depend upon steady, on-going productivity increases (which is the sine qua non for general development success, as explained in the previous section). Indonesia can hope to buttress such productivity gains on the basis of its richer resource base potential, if these resources are properly used in local processing and manufacturing industries. It can also hope to get some assistance in technology transfer from aid donors and partners in development wishing to export capital goods, components, and management consultancy. It may also hope to obtain special concessions when assisting its manufactured exports, from Japan for example, in exchange for contracts that guarantee access to its energy and other strategic resources.

A more uncomfortable question is: where does Canada fit in if this neatly designed process of economic integration moves inexorably toward a self-contained arrangement? Canada can obviously have its own trans-Pacific arrangements with Japan, exporting "logs and rocks" (even profitably) in exchange for Japanese "thinking computers" and South Korean cars, but what about Canada-Indonesia economic relations? In the delightful wonderland of an hypothetical "two-country model", one can argue with enthusiasm that it makes sense to trade Indonesian bananas for Canadian wheat, or even Indonesian tin for Canadian uranium. But no such climatic or divinely ordained imperative suggests that is has to make sense to trade Indonesian shirts for Canadian high-tech computers, especially when we come out of the classroom and into a multi-country, aggressively competitive world. It is possible that Chinese shirts and Singaporean computers are not only cheaper, but possibly more accessible, more reliable, more up to date, and more attractive in any of a dozen respects. Not only are there more attributes when it comes to manufactured goods, but "comparative advantages" are mostly "acquired" or "created" rather than "endowed". They become embodied in "human capital" and in "social and institutional capital" through learning by doing, R&D, economies of scale, agglomeration and teamwork, and a host of cultural and environmental factors so elusive and mysterious that they have been referred to as creating "X-efficiency" or the "unexplained residual" in differential productivity performance.[23]

When it comes down to business reality, it is "delivered competitive advantage", not abstract or ideal bilateral comparative advantage that determines a firm's ability to survive in export markets. This may in fact reflect comparative advantage in the orthodox sense of differential relative prices based on different resource endowments. But while such a conceptual bedrock is useful in proving the case against excluding "cheap Asian textiles" or "cheap Canadian coal" as unfair to weavers in Canada and miners in Japan, it does not take us very far in explaining the complex matrix of commodity trade or why some firms survive and others do not. Delivered (actual or revealed) competitive advantage can also reflect the whole complex of "X-efficiency" factors, and moreover can be very substantially affected by taxes and subsidies, barriers to entry, work rules and patent laws, pollution disposal regulations, and a myriad of other institutional realities which may be overwhelming to any underlying considerations based on where resources are distributed on the globe.

In evaluating Canada's economic prospects across the Pacific, it has to be remembered that established commercial relations with Indonesia still rank relatively low, despite the economic assistance program, the ongoing dialogue and genuine goodwill in Canada-ASEAN accords, and the frequent visits back and forth. This becomes clear from reading A Review of Canada's Trade Policy: A Background Document to Canada's Trade Policy for the 1980s. Indonesia does not appear in the list of "Top 40 Countries" with which Canada trades (though Singapore and Malaysia do), and while ASEAN is mentioned parenthetically in the text as a NIC trading opportunity, Indonesia does not receive a single mention. Under pressure of short-term crisis management, it is natural to look for quick returns and solutions that are close at hand. An export dollar is an export dollar, whether it is earned in the United States, Mexico or Indonesia, and transaction costs and turn-around time are often lower in familiar and proximate environments. Export credits (if not all of the CIDA-funded and other LDC-oriented schemes) still apply, and tax write-offs, commercial credit, and income procurement are often more easily manipulated under Canada-United States and Canada-EEC arrangements than under Canada-LDC arrangements. And when one takes into account the costs of coping with counter-trade requirements, other sets of regulations and interference, inefficient and unpredictable port and shipment facilities, and the host of other difficulties, it is understandable how prospects for expanding Canada-Indonesia trade might not appear on the immediate agenda.

Trading links based on "rich country/poor country" differences can be very treacherous as the basis for long-term trading arrangements. Not only do they imply fossilization of a "leader/follower" industrial status--such as when the poor country attempts to emulate the lifestyle of its more sophisticated partner--but they tend to relegate the follower to perpetual labour-intensity and low incomes, while the benefits of R&D, which are mainly embodied in capital-intensive and technology-intensive industries, go to the favoured and increasingly commanding partner. As labour-intensive industries have easy access to markets, they tend to be extremely competitive. As a result, even the small amount of R&D that is applied to them tends to get skimmed off the top in the form of lower prices to the customer nation, while more trade unions and other monopoly/monopsony powers enable productivity gains in richer countries to be taken up in higher incomes, and the gains therefore are not automatically passed on to yield lower export prices. The rich/poor consideration also gives a poor rationale for Canada-Indonesia trade because there are several other rich countries with larger high-income markets, and many poor countries that may need Canada's wheat and rapeseed oil more urgently than Indonesia.

Canada's value as a partner in development to Indonesia will be assessed according to the paradigm under which each of these countries' futures is perceived. Will Canada build upon its well-established, subsidized, high-tech industries and become a major industrial country as well as a primary producer and exporter? What niche along the technological frontier will it manage to make to hold its own against all comers, or those comers to which Indonesia might turn instead? Will Singapore be quicker to capture the Indonesian market or provide more appropriate technology, better servicing, and other package deals to its ASEAN ally? Will Indonesia continue with the luxury of "giantism" and seek to create its own high-tech capabilities using Canadian technology and Canadian aid to achieve this? Or will Indonesia's industrial and product structure become more idiosyncratic, less "materialist or Westernized", so that the Canadian way of life no longer seems to be an idyllic goal? And how will governments in the two countries perceive and implement their industrial strategies, investment priorities and support mechanisms, and to what extent will they hold firm to them?

Over the long term, nations are kept honest in their choice of activities by the inexorable widening of differential productivity and by eventual citizen revolt against absurdly inflated prices and sluggish job opportunities--if not by balance of payments and international credit crises. Periodically, big jolts occur, as export drives based on new technological breakthroughs or determined industrial expansion in selected fields sweep past the tariff and non-tariff walls protecting spurious or outmoded comparative advantages. One such "product-shock" in the offing for some producers, both in Indonesia and in Canada and potentially in every other country around the Pacific Rim, is the competition that manufactured exports from mainland China can be expected to bring into play between now and the year 2000. China is in an even better position than most to "select" the intermediate technology sectors in which it intends to create its comparative advantages.[24] Given its resources, manpower, working conditions, and control over choice of technology, China can simply make it uncompetitive for any rival already established in that export trade. This uncertainty, if nothing else, should prompt countries to move with extreme caution when choosing the industrial starters by which they hope to secure viable industrial jobs for their people, jobs with the prospect of rising real incomes over time. These countries will need to be stayers to be winners, and once again, we should remind ourselves that this applies to Canada no less than to Indonesia, though the costs of failure may not be quite as drastic.

Canada's economic participation and opportunities in Indonesia's development can be assessed against either the short-term or longer-term perspectives sketched out in the overview. The short-term framework will soon be made clearer with the publication of the agenda for Repelita IV (1984-89). It is still too soon to predict if any new departures in priorities or development strategy will be unveiled, but it seems likely that the major goals will be similar to those enunciated for Repelita III. Oil and other extractive industries will continue to provide the bulk of revenues and foreign exchange, which will be supplemented by plans for a further extension of the plantation and estate crops sector. More value-added processing of primary exports will be sought, and more import substitution and Indonesianization in manufacturing output will be encouraged. Stepped-up job creation through incentives awarded to more labour-intensive investment projects and increased output of low-cost consumer goods will be part of the plan to promote the "socio-economic equality" objectives and to keep down the rate of inflation. The agricultural modernization and transmigration resettlement programs will seek to spread development effects through rural and Outer Island regions, and agro-based industries and agricultural servicing and support activities (such as fertilizer, irrigation, farm implements) will be given more priority. Also, it is likely that there will be some upgrading of basic needs amenities in urban and rural areas.

With regard to short-term requests for foreign economic aid, mega-projects in power, transportation, and communications will continue to be given preference in appropriations as the government seeks to extend modernization and administrative processes to all corners of the country. Of the US $13 billion foreign-exchange cost of priority projects listed for the 1983/84 fiscal year, over $8 billion (or 63 per cent) was slated for these three sectors alone.[25] Agriculture and irrigation projects accounted for $2 billion, with $845 million allotted to manufacturing projects, $103 million to mining, $317 million to water projects, $343 million to education, $334 million to health and population projects, $416 million to regional development and $16 million to transmigration projects. Among the technical assistance projects for which proposals for economic assistance were submitted, 76 were in power, transport and communications, 58 in agriculture and irrigation, 46 in industry, 54 in mining, 33 in education, 38 in water supply and health, and 23 in trade and co-operatives.

In the context of Repelita IV, therefore, Indonesia will continue to view Canada's participation mainly as a means to build roads, power supply and other infrastructure, as a source of technical assistance, and as a stand-by supplier of food, fertilizer and a miscellany of other items projected to be in short supply. The shopping list under this last category is likely to be somewhat longer on account of the stringent foreign exchange situation and the need to decelerate the inflationary forces released by the March devaluation and the dismantling of many subsidies on basic needs and agricultural inputs. Canada has also established a reputation in telecommunications, aerial mapping, and geological and oceanographic surveys, and in various forms of energy technology (including possibly a contract for a Candu reactor, as a treaty of understanding on non-military uses was recently ratified with Indonesia). It is also coming to be recognized as a front runner in resource management and environmental-impact monitoring and mitigation capabilities.

Canadian firms will continue to look for most of their business opportunities in heavy construction and related engineering and consulting fields, though the Indonesian government has been making determined efforts to increase the share of work going to local contractors.[26] It is also likely that there will still be a wide range of opportunities for most types of professional and development skills, both in gap-filling and in training roles. For example, a World Bank estimate for the remainder of the 1980s suggests that there are many shortfalls. (See Table 11)

These data relate only to a few of the more obvious categories, and similar needs will surface in the vocational, educational, and health facility fields. Activities for Canadian and international NGOs are also likely to be in demand, and in some scenarios, may prove to be absolutely vital in helping to sustain and enhance livelihood security at the village level.[27]

In agriculture, the main opportunity for foreign participation as advertised by the government lies in plantation and estate development; other spheres will likely remain restricted to locals. The government is hoping to expand the size of its plantation sector from its present eight million hectares to about ten million hectares by 1990. By upgrading crops and organization on existing plantations, it hopes to more than double the US $2.5 billion (1980) export earnings from this sector, making it second only to oil and gas as a source of foreign exchange.[28] Major preferred crops include rubber, palm oil, coffee, tea, cotton, sugar, tobacco, pepper, cocoa, and cashew nuts. Some may see this as "history revisited", especially when terms granted to agribusiness in nucleus estates are reminiscent of the terms of operation of joint-stock companies during the so-called liberal phase of Dutch administration. Opportunities being promoted include development and management contracts under government-sponsored Nucleus Estates and Smallholder (NES) schemes, or specific joint ventures with state-owned companies. For example, offers were recently advertised for three oil palm projects in Riau Province, Sumatra, calling for investments ("single foreign partner preferred"), in the range of US $60-100 million. Also advertised were offers for a US $3.6 million molasses-to-alcohol plant in South Sulawesi and a US $2.8 million liquid sugar plant in East Java. Domestic and foreign investors are only permitted to establish processing facilities for estate crops when they are involved in operating their own joint-venture estates.

Forestry, reforestation, forest management, and forestry training also represent opportunities for Canadian technical involvement, especially with the passage of the recent Act Concerning Basic Provisions for Management of the Living Environment, which hopefully will reverse the country's poor history of resource management. New programs of instruction will be required, given the enormous range of ecological variation and fragile environments that its geography presents, and Indonesia is basically starting from scratch in the techniques of environmental impact assessment and monitoring.[29]

Other agricultural processing and food production is rapidly being closed off to foreign participation. Already, fields such as poultry raising and processing, cattle butchering and corned beef canning, fish canning and preserving, milk processing, and the manufacturing of sauces and most vegetable and animal fats and oils are explicitly excluded. Opportunity still exists in cattle breeding and raising, vegetable canning, freezing and dehydration, with most dairy products and many speciality products not traditional to Indonesia. The extension of state enterprise in rice intensification schemes has pre-empted most opportunities for agricultural services and supply (such as fertilizer, pesticides, improved seeds), though these are often imported from overseas suppliers by the government agencies involved. Much potential exists, however, in the building of irrigation, tube well, and piped water systems, and in the construction of improved grain storage, processing and marketing facilities, as well as the construction of hospitals, clinics, and other urban and community social service amenities.

There is evidently much scope for modernization--and much talk of the role for foreign investment--in the upgrading of Indonesia's fishing industry and associated coast-guard and inter-island ferry systems. The estimated total fishing yield for 1981 was below two million tonnes, 98 per cent of which was absorbed by domestic markets, and it is estimated that Indonesia's recently recognized claims to three million square miles of rich archipelagic waters could easily double the total catch on a sustained yield basis. An effort to launch a modern trawler fleet in the 1970s (financed mainly by ethnic Chinese businessmen) angered small fishermen, apparently because price competition cut the value of their catch and not because fishing competition reduced their catch size. (Many trawlers were attacked and sabotaged, causing the government to prohibit trawlers from traditional coastal fishing grounds.) The export of fish caught in deeper waters offers a potentially profitable range of opportunities, but has been handicapped by stringent quality and health inspection standards applied to imports into many consuming countries (often designed more as non-tariff barriers to protect local fishing interests). The main foreign interests active in this sector are the Japanese, who focus mainly on prawn and tuna fishing. With better handling methods, efficient refrigeration and canning facilities, and better coastguard regulation and quality inspection, investment in this sector could yield more food value and/or more foreign exchange in an increasingly protein-hungry world, where competing stocks of fish in other waters are often becoming seriously depleted.

The real growth potential, however, and the one that will be critical to Indonesia if it hopes to provide its growing population with productive employment, must be found in the manufacturing sector. The World Bank has recently agreed to fund about 50 manufacturing industry studies to assess the feasibility of these sectors and the potential for foreign participation, as well as to assess how BKPM's structure of investment incentives and regulations might be amended to better facilitate their development. It is certain that US, Japanese, South Korean, Australian and other businessmen are aware of the opportunities that this might offer. It is less certain that Canadian businessmen and their promoters are as well attuned to where they might fit in. Canadian involvement in Indonesian development, both CIDA-funded and commercial ventures, have mostly been located in Outer Island and other peripheral locations and not in the political, demographic, and industrial heartland of Central Java. Canada has also been concerned mainly with "background" infrastructure construction, not with joint-venture participation or people-oriented technical assistance. There has also been little in the way of institutional linkage and exchange apart from at the somewhat ritualistic ministerial and diplomatic level, and only meagre efforts have been made to promote bridging and networking among professional and business organizations. Therefore, despite Canada's generally "good reputation" as a polite, non-aggressive, and well-meaning interlocutor, it may be left behind as a long-term partner when it comes to sorting out those who are prepared to commit themselves to what will likely be a tough and testing phase in Indonesia's development.

Increased Canadian and other foreign investment would undoubtedly be encouraged in these, as well as possibly in many manufacturing lines, if the movement towards an ASEAN free trade area were to achieve a real breakthrough. There remain real obstacles to this, however, despite the growing list of negotiated items (most of them relatively trivial) exempt from intra-ASEAN duties. Not only do all member countries have excess capacity and untapped potential across a broad range of industrial production, but they are unwilling to face the adjustment costs that industrial "rationalization" would entail. Indonesia is particularly aware that its "infant industries" are generally less competitive than those of its neighbours and thus fears retrogression toward greater primary producer dependency.

Industrial specialization within the region will thus have to proceed gradually, through systematic and negotiated "complementation" whereby members agree to restrain local production in specified areas in order to accommodate producers from each of the other countries. Experience has shown, moreover, that it is easier for a group of countries to agree on the concept of deliberate complementation within a regional arrangement than for the member countries to actually carry out the reductions in domestic production that may be required or to prevent the establishment of new industries in particular sectors. Moreover, for most industries in the ASEAN area, it is not obvious how "optimal" locations could be assigned on the basis of the principle of comparative advantage; schemes which in effect would grant monopoly positions to inefficient industries in one country would be very difficult for the other countries concerned to accept.

Armchair criticism of Canadian business performance, whether at home or abroad, is a favourite pastime of Canadian academics, surpassed only by the pleasure derived from castigating bureaucrats and policy-makers in Ottawa. We need not reiterate all the traditional reasons brought forward to explain why Canada so often ranks as a "high cost" producer, especially over a range of manufactured products. Canadian producers are accustomed to higher levels of protection and subsidization, but they also have genuine disadvantages as compared to US, Japanese, Korean, or even Australian producers. The awesome sogo shosha Japanese trading companies, able to package in one deal all aspects of export-import, credit and finance, technology transfer, construction, training, shipping, and all other service facilities, make a formidable rival to contend with.[30] South Korea, Thailand, and other countries are seeking to form equivalent phalanxes, and even the United States passed an Export Trading Act in October 1982 to facilitate the formation of similar alliances of banking, trading, production, and service facilities without violating US anti-trust laws.

Canadian government officials responsible for fostering Canada-Indonesia commercial ventures have also sought to encourage a consortia approach, but the best that they hope for would be a much looser and more casual arrangement. Such unnatural partnership is alleged to be at variance with long-established traditions of competition and mutual suspicion, even among firms that are not direct rivals in their product lines or likely to be so in future areas of expansion. Whether this is more attributable to capitalist independence or to assurances of getting special individual perks from government, will be left to individual judgement and predilection. The fact is that Canadian businesses do have access to a wide array of easily accessible and undemanding facilities that encourage them to assess their potential as overseas suppliers or investors in any one of a dozen types of endeavour, such as product-sharing and management contracts with government agencies, catering, procurement and construction of exploration projects, product licensing, management consulting, and various types of technical assistance projects.

Without anything near such a generous set of subsidy arrangements, Australian firms have participated in building a two-way trade with Indonesia that has been growing at an average rate of 65 per cent per annum for the last seven years, exceeding a level of US $1 billion in 1982. Tourism provides another US $50 million per annum of spending by Australians in Indonesia (albeit encouraged by subsidized airfares and relative proximity), and some one hundred Australiam firms have representation in Indonesia, involving a direct investment estimated at US $800 million, plus an additional US $40 million in technical assistance and US $150 million in project assistance. Australia has a population that is 40 per cent as large as Canada's, it has a much narrower and more austere resource base, and a much less privileged access to American technology, markets, and investment. Could the Canadian dilemma be that there is too much subsidy at home for us to risk losing our innocence abroad?

Notes

1. For more details, see A.D. Small, "The Developing Dialogue Between Canada and ASEAN" and S. Hervouet, "Canada and ASEAN: Renewed Interest Between Two Distant Partners".
2. In the 1980s, Thailand was also designated as a "country of concentration".

3. For some reviews of Canada's various roles in recent Southeast Asian history, see T. Cohn, G.B. Hainsworth and L.J. Kavic (eds.), Canada and Southeast Asia: Perspectives and Evolution of Public Policies.

4. For a more detailed review of the current international crisis and status of the North-South dialogue, see G.B. Hainsworth, "Surviving the New International Disorder".

5. See, for example, the opening statement of Trade Minister Regan to the 1983 Pacific Rim Opportunities Conference in Calgary. Several statements by ASEAN and East Asian spokesmen also noted the absence of any clear "third option" initiatives in Canada's trade strategy toward them.

6. Since writing this, the situation has been made more explicit by publication of A Review of Canadian Trade Policy: A Background Document to Canadian Trade Policy for the 1980s, which confirms the neo-Mercantilist policy orientation. The focus is very much on how Canada can increase its exports, mainly to other "more developed country" markets, and, it might be noted, the word "Indonesia" does not appear on any of the 240 pages.

7. "Reorganization for Economic Development", Press Release on Prime Minister Trudeau's directive (12 January 1982.)

8. Another source of difficulty, however, was the re-specification of limits on types of locomotive equipment while negotiations by another government agency with Quebec-based Bombardier Ltd. were underway for equipment that did not meet these specifications.

9. The list of 107 "Canadian Companies Operating in Indonesia" in CIDA's booklet on industrial cooperation opportunities seems to be based on wishful thinking about every contractor that fulfilled part of a CIDA contract relating to Indonesia. This assessment seems to be confirmed by on-going research into "A Profile of Canadian Corporate Activities in the Pacific Region" being conducted by J.W.C. Tomlinson and C.L. Hung at the Institute of Asian Research, U.B.C. (forthcoming).

10. For more detailed information on investment regulations and incentive programs in effect, see Canadecom International, Canada-ASEAN Industrial Cooperation Opportunities, Volume I: Indonesia, and compare with P.B. Gurney, "Joint-Venture Investment in Indonesia". Many investment promotion booklets are also issued by the Indonesian Government in addition to a monthly newsletter, Indonesia Development News, which is widely distributed in North America and which reflects current developments and priorities.
11. Another consequence is that linkage to local suppliers is also reduced as large ventures feel they have to provide self-contained facilities as far as possible. This raises total capital and front-end costs of operation, import content and foreign exchange costs, and reduces local employment and income effects.
12. See, for example, the speech by Suhartoyo, the new head of BKPM, at the May 1982 business meeting in Vancouver, reported in Indonesian Development News, June 1982, where the BKPM priority list is also outlined.
13. See G.B. Hainsworth, "Indonesia: Bonanza Development Amidst 'Shared Poverty' " in Current History 77 (December 1979): 199-200 and Hainsworth, "Indonesia: Dilemmas of Dichotomous Development" in Southeast Asian Economic Review (April 1981): 1-17, for a discussion of such paradoxical outcomes.
14. For a discussion of the implications and various interpretations of Pancasila in contemporary politics and Indonesia's development see G.B. Hainsworth, "The Political Economy of Pancasila in Indonesia" in Current History (April 1983): 167-71, 178-80.
15. Colin MacAndrews, H. Benjamin Fisher and Atar Sibero, "Regional Development Planning and Implementation in Indonesia: The Evolution of a National Policy" in Too Rapid Rural Development: Perceptions and Perspectives from Southeast Asia, edited by Colin MacAndrews and Chia Lin Sien, pp. 79-121, (Athens: Ohio University Press, 1982).

16. Projection as reported in The Economist, 24 September 1983, from where some of the other data in this section are also taken. Their estimate for private indebtedness of "around US $4 billion", however, seems much too low, especially when compared with the World Bank Debt Tables estimate of over US $9 billion for 1981.

17. Commentary on this can be found in G.B. Hainsworth, "Economic Growth and Poverty in Southeast Asia: Malaysia, Indonesia and the Phillipines" in Pacific Affairs (Spring 1979): 5-41.

18. Environmental Studies for Development in Indonesia, (Washington: World Bank, 1983), for some account of ecological fallout, and, for an overview of social and economic effects, see Swadesh R. Bose, "Has Economic Growth Immiserized the Rural Poor in Indonesia? A Review of Conflicting Evidence" in Village-Level Modernization in Southeast Asia: The Political Economy of Rice and Water, edited by G.B. Hainsworth, pp. 53-69, (Vancouver: U.B.C. Press, 1983).

19. William M.F. Mansvelt and P. Creutzberg, Changing Economy of Indonesia: A Selection of Statistical Source Materials. Volume I: Indonesia's Export Crops, 1816-1940, (The Hague: Martinus Nijhoff, 1975).

20. For a fuller discussion of the problems that these and other such production strategies as Indonesia adopt might entail, see G.B. Hainsworth, "Performance and Perspective in Economic Development in Southeast Asia: Traditional Strategies and New Approaches" in The Past in Southeast Asia's Present, edited by Gordon P. Means, pp. 20-47, (Ottawa: Canadian Council for Southeast Asian Studies, 1978).

21. Roy A. Matthews, Canada and the 'Little Dragons'.

22. The major consideration obstructing this as a widespread phenomenon seems to be the high operating and export costs resulting from inefficient and over-regulated working arrangements. These are avoided to some extent in the export-oriented industrial estate enclaves, but spread effects from these are correspondingly limited.

23. Harvey Leibenstein, General X-Efficiency Theory and Economic Development, (New York: Oxford University Press, 1978).

24. Should the concept of deliberately "created comparative advantage" jar with the "natural selection" and "natural harmony" paradigm with which it is traditionally enunciated, two examples may be helpful. Cotton cannot be grown in Lancashire yet Britain somehow managed to shift the "optimal location" for cotton manufacturing, at least for a century or so, from India and Egypt to there. Japan, after Meiji, was determined to break dependence on foreign shipping, and invested billions of yen in subsidies for many fruitless efforts before becoming the world's "lowest cost producer" after many decades of determined learning-by doing.

25. Republic of Indonesia, List of Project Proposals, 1983/84, and List of Technical Assistance Proposals, 1983/84, (Jakarta: BAPPENAS, 1983).

26. The value of construction work in the 1970s grew at an average rate of 16 per cent per annum, reaching a contract value in excess of US $50 billion in 1981. About 70 per cent of this was financed by the public sector, and about 50 per cent was carried out by foreign contractors. Out of a total of 23,000 local construction firms, about 80 have staffs of 100 or more. However sub-contracting is very prevalent, even on very large jobs, and over 40,000 mandas (sub-contractors) are estimated to have accounted for over 85 per cent of the labour supply in the construction industry. Under a recent World Bank loan of US $30 million, Indonesia is making determined efforts to upgrade skills at all levels among local contractors, engineers, surveyors, etc.

27. G.B. Hainsworth, "Private Voluntary Organizations and Socio-Economic Security and Equality in Indonesia, Prisma: The Indonesian Indicator (June 1983): 46-63, also translated as "Lembaga Pengembangan Swadaya Masyarakat dan Perataan Pembangunan", Prisma: Wajah Swadaya dalam Pembangunan, (April 1983). As a postscript, it might be noted that new "partners in development" status for indigenous NGOs has just

been announced in Indonesia, and both CIDA and IDRC are responding to the counterpart opportunities that this might entail.

28. "Government Sector Seeks Partners for Six Plantation Joint-Ventures", Indonesia Development News, (July 1982).

29. A CIDA-funded "Environmental Manpower Development" project for Indonesia based at Dalhousie University will be a key component of this.

30. Yoshi and Rebecca Tsurumi, Sogoshosha: Engines of Export-Based Growth, (Ottawa: Institute for Research on Public Policy, 1980).

Table 1: Selected Basic Economic Data Indonesia and Other ASEAN Countries

	Indonesia	Malaysia	Singapore	Thailand	Philippines	ASEAN
Population (mill)	150.5	14.4	2.4	48.1	49.5	264.9
Land Area (000 km^2)	1919.0	330.0	0.6	514.0	300.0	3064.0
GNP (US $ bill)	80.0	24.4	12.7	35.1	38.0	191.0
GNP per cap. (US $)	537.0	1690.0	5225.0	729.0	767.0	720.0
Exports (US $ bill)	22.3	13.3	9.4	6.9	7.2	59.1
Imports (US $ bill)	15.5	14.9	12.5	8.9	9.2	61.0
Total Trade 1980-82 (Exports + Imports)						
Canada-ASEAN (C $ bill)	602.0	613.0	986.0	492.0	561.0	3254.0
as % Canada-ASEAN	18.5	18.8	30.3	15.1	17.2	100.0
as % Country total						
GNP Growth Rates						
1970-80	7.6	7.8	8.5	7.2	6.3	7.5
1981-83	5.6	6.7	8.6	5.8	4.1	6.0
Exports/GDP (%)						
1971	14.2	38.7		11.9	14.5	
1976	22.9	47.9		18.0	14.2	
1981	26.7	50.8		18.7	14.5	
Foreign Investment Total (US $ bill)						
By Major Investor (%)						
Japan	38.7	23.4	15.3	34.9	25.3	
U.S.A.	18.9	18.7	32.9	16.3	33.1	
U.K.	1.7	12.1	13.7	5.0	8.4	
West Germany	3.4	2.4	3.1	1.9	1.4	
Netherlands	3.4	na	13.8	1.9	na	

Table 2: Data on International Economic Assistance to Indonesia
Selected Years, 1972-82 (US $ millions)

	1972	1976	1980	1981	1982
Total Debt Outstanding	5,206	14,534	24,354	27,091	30,741
Official multilateral	406	1,960	5,216	6,325	7,565
Official bilateral	3,988	6,868	11,336	11,393	11,724
Private creditors	812	5,706	7,802	9,373	11,452
Annual Commitments	864	3,133	4,183	5,172	5,778
Official multilateral	123	673	1,019	1,175	1,348
Official bilateral	383	1,024	1,496	1,155	1,212
Private creditors	358	1,436	1,668	2,842	3,218
Annual Disbursements	805	2,332	2,536	2,566	4,251
Official multilateral	36	291	431	473	712
Official bilateral	372	629	656	883	1,073
Private creditors	397	1,412	1,449	1,210	2,466
Principal Repayments	93	434	953	1,001	1,148
Net Flows	712	1,899	1,584	1,566	3,102
Interest Payments	47	327	819	977	1,160
Net Transfers	665	1,572	765	589	1,942
TOTAL DEBT SERVICE (TDS)	140	761	1,772	1,978	2,309
International Reserves	580	1,505	6,803	6,248	4,562
Terms of Economic Assistance					
Official Creditors					
Interest rate (%)	2.2	7.0	5.5	7.9	9.0
Maturity (years)	34	21	25	21	21
Grant elements (%)	64	21	35	14	7
Private Creditors					
Interest rate (%)	9.0	8.1	12.3	9.2	9.7
Maturity (years)	5	8	10	11	11
Grant element (%)	3	6	-12	1	0
Ratios: TDS/GNP	1.3	2.1	2.7	2.4	2.6
TDS/Exports	7.6	8.7	8.0	8.3	
Percentage Shares in Total Official Bilateral Aid Disbursements (Net Transfers)					
Canada	2.7	3.7	1.7	2.7	3.6
U.S.	34.3	22.3	13.9	12.9	9.5
Japan	19.7	29.6	41.5	37.5	39.2
Australia	5.1	4.8	5.7	5.6	6.1
West Germany	11.9	4.5	7.8	21.7	18.6
Netherlands	10.9	5.9	10.1	8.5	14.0
France	2.7	4.4	5.1	5.6	3.6
All others	12.7	24.8	14.2	5.5	5.4

Sources: World Bank, World Debt Tables, 1983-84, Washington, 1984 and earlier years.
OECD, Geographic Distribution of Financial Flows to Developing Countries, Paris, 1984 and earlier years.

Table 3: Canada's Bilateral Aid Disbursements, in Total and to Indonesia Fiscal Years 1968/9--1982/3 (Canadian $ millions)

	1968/9	1969/70	1970/1	1971/2	1972/3	1973/4	1974/5	1975/6	1976/7
Total	158.59	212.65	278.53	283.88	333.38	367.94	502.63	525.71	477.73
Indonesia	0.97	2.33	3.57	3.95	14.75	21.64	19.52	36.70	22.43
Ind/Total (%)	0.61	1.09	1.28	1.39	4.42	5.88	3.88	6.98	4.70
Growth Rates (%)									
Total	-	34.1	30.98	1.92	17.42	10.37	36.61	4.59	-9.13
Indonesia	-	240.20	53.21	10.64	373.42	46.71	-9.80	88.01	-38.89

	1977/8	1978/9	1979/80	1980/1	1981/2	1982/3	1968/9 - 1982/3
Total	552.86	559.35	598.79	581.50	671.36	716.05	6,820.95
Indonesia	13.19	12.72	11.75	17.95	27.38	28.84	237.69
Ind/Total (%)	2.39	2.27	1.96	3.09	4.08	4.03	3.48
Growth Rates (%)							
Total	15.73	1.17	7.05	-2.89	15.46	6.7	
Indonesia	-41.19	-3.57	-7.63	52.77	52.53	5.3	

Source: CIDA.

Table 4: Canada-Indonesia Commodity Trade and Balance of Payments Selected Years, 1970-82 (Canadian $ millions)

	1970	1975	1980	1981	1982
Canadian Exports	16.4	64.7	215.0	94.1	197.2
Indonesia Exports	0.5	14.2	28.9	37.0	30.3
Balance of Trade	15.9	50.5	186.1	57.1	166.9
Ratio: Can/Ind.	32.8	4.6	7.4	2.5	6.5

Source: Statistics Canada, Exports by Countries, December 1982.

Table 5: Indonesia-Canada Commodity Exports (Canadian $ millions)

	1979	1980	1981	1982
Crude Natural Rubber	17,988	19,337	28,255	19,065
Tea, black	3,929	3,783	3,951	3,281
Palm oil	7,295	3,130	341	335
Textile fabrics	1,383	94	292	90
Coffee, green	1,765	368	217	220
Tin blocks, pigs, bars	1,133	461	-	191
Lumber, veneers, plywood	-	396	1,407	1,180
Other	8,615	1,344	2,498	5,907
Total	42,108	28,913	36,961	30,269

Source: Statistics Canada, Imports by Countries, December 1982.

Table 6: Indonesia, Major Export Products by Volume and Value, 1981 and 1982

Product	Volume (tons)		Value (U.S. $ 000)	
	1981	1982	1981	1982
Crude Oil	64,077,061	56,069,961	16,953,476	14,821,002
Oil Products	5,280,016	2,801,100	1,210,672	637,309
Natural Gas	9,121,804	10,240,812	2,499,035	2,905,798
Non-oil and Gas	18,874,243	29,344,531	4,501,320	3,929,231
TOTAL	97,353,124	98,456,404	25,164,503	22,293,339
Detail of Non-oil and Gas Exports				
Tin	35,314	28,610	457,270	367,393
Bauxite	956,369	746,784	14,023	11,102
Nickel ore	842,045	721,518	32,626	22,412
Granite	932,497	714,068	6,180	5,104
Cement	453,961	206,734	19,153	8,422
Urea fertilizer	16,782	45,033	4,251	10,083
Wood	7,217,650	5,028,839	1,080,025	876,288
Logs	5,570,601	2,938,158	662,433	331,766
Sawn timber	901,639	1,036,884	211,490	216,455
Plywood	434,212	677,018	161,411	269,881
Other	311,198	376,779	44,692	58,185
Rubber	808,733	797,608	828,229	602,148
Palm Oil	2,264	2,343	14,856	17,381
Palm Kernels	196,361	259,476	106,938	96,247
Sliced Copra	321,836	350,258	35,757	36,126
Coffee	210,595	226,985	345,943	341,701
Tea	71,259	63,660	100,837	89,493
Pepper	33,996	36,327	47,151	44,874
Manioc	372,627	211,330	32,746	15,951
Tinned Fruit	3,963	2,176	1,722	505
Juice	0	108	0	94
Canned Biscuits	82	116	165	229
Canned Meat	0	2	0	2
Canned Fish	874	917	3,045	1,877
Fresh/frozen Tuna	14,013	18,788	15,416	19,863
Shrimp	24,728	25,455	162,661	181,356
Tobacco	25,138	19,487	50,693	37,981
Cigarettes	203	346	2,418	4,262
Handicrafts	838	1,088	5,468	8,083
Garments	12,366	16,616	95,257	116,938
Rattan	67,473	75,976	68,648	75,767
Furniture	705	781	1,483	2,004
Paper	1,149	5,599	458	2,505
Tires	10	59	24	117
Steel Pipe	1,050	1,951	830	1,483
Glass/glassware	4,192	5,622	2,419	3,313
Others	6,245,171	19,729,872	964,629	923,129

Source: Central Bureau of Statistics, Indonesia Development News, April 1983.

Table 7: Canada-Indonesia Commodity Exports by Selected Groupings

	Values (Current Cdn. $ thousands)			Value Ratios	
	1980	1981	1982	1981/80	1982/81
Primary Resource Exports					
Chemicals and minerals	32,440	34,444	32,428	1.06	0.94
Asbestos	8,267	9,071	7,313	1.10	0.81
Sulphur	7,275	11,542	7,417	1.59	0.64
Aluminum and alloys	11,163	7,692	4,796	0.69	0.64
Zinc and alloys	2,012	2,677	10,129	1.33	3.78
Other basic chemicals	457	373	315	0.82	0.85
Other basic metals	728	1,489	1,288	2.05	0.87
Other non-metalic minerals	2,538	1,600	1,170	0.63	0.73
Pulp and paper	21,907	19,416	21,538	0.89	1.11
Wood pulp	6,270	4,991	7,805	0.80	1.56
Newsprint	5,143	6,439	7,638	1.25	1.19
Paperboard	3,857	2,777	2,556	0.72	0.92
Other paper	6,637	5,209	3,539	0.78	0.68
Total above items	(54,347)	(53,860)	(53,966)	(0.99)	(1.00)
Food and fertilizer	1,412	3,401	24,485	2.41	7.20
Fertilizer	-	-	8,594	-	-
Wheat	-	-	6,773	-	-
Rape seed oil and kernels	-	-	4,163	-	-
Tobacco	39	195	2,290	5.00	11.74
Other food and vegetable products	1,373	3,206	2,665	2.34	0.83
Petroleum (marine fuel)	73,070	-	-	-	-
TOTAL Primary Exports	128,829	57,261	78,451	0.44	1.37
Intermediate Product Exports					
Fabricated iron and steel	5,860	5,605	8,400	0.96	1.50
Textile and related fibres	9,293	8,266	7,511	0.89	0.91
Synthetic rubber and plastics	5,218	3,415	14,611	0.65	4.28
Plastic shapes and forms	3,927	2,217	1,713	0.56	0.77
Other textile materials	22	154	84	7.00	0.55
Other fabricated materials	24	56	24	2.33	0.43
Waste and scrap materials	2	-	1,972	-	-
TOTAL Intermediate Exports	24,346	19,713	34,315	0.81	1.74

Table 7 (continued)

	Values (Current Cdn. $ thousands)			Value Ratios	
	1980	1981	1982	1981/80	1982/81
Manufactured Product Exports					
Transport and communications	54,688	2,188	38,401	0.04	17.55
Ships, boats and parts	53,441	211	26	0.00	0.12
Railway and rolling stock	-	-	23,613	-	-
Aircraft, complete	-	-	10,418	-	-
Aircraft engines and parts	322	436	1,170	1.35	2.68
Telecommunications equipment	925	1,541	3,174	1.67	2.06
Industrial equipment	5,965	8,285	43,039	1.39	5.19
Mining and excavating equipment	752	777	12,721	1.03	16.37
Trucks and motor vehicle parts	24	1,750	329	72.92	0.19
General purpose industrial equipment	428	390	19,912	0.91	51.06
Electrical engines and generators	450	1,390	1,462	3.09	1.05
Agricultural machinery and equipment	27	678	376	25.11	0.55
Other special purpose industrial equipment	2,136	1,414	2,327	0.66	1.65
Electrical lighting and distribution equipment	180	269	53	1.49	0.20
Navigation equipment and parts	79	-	1,548	-	-
Other scientific equipment	739	704	1,609	0.95	2.29
Hand tools and cutlery	440	884	887	2.01	1.00
Office machines and equipment	577	779	1,693	1.35	2.17
Prefab buildings and structures	68	159	49	2.34	0.31
Other equipment	65	91	73	1.40	0.80
Manufactured consumer goods	381	461	2,435	1.21	5.28
Apparel and footwear	86	112	79	1.30	0.71
Other consumer goods	12	30	113	2.50	3.77
Medical and pharmaceutical	283	74	1,157	0.26	15.64
Firearms	-	245	1,086	-	4.43
TOTAL Manufactured Exports	61,034	10,934	84,075	0.18	7.69
Miscellaneous and unassigned	4	4,792	271	-	-
TOTAL COMMODITY EXPORTS	214,213	92,700	197,112	0.43	2.13

Table 8: Indonesia, Foreign Investment Approvals by Country of Origin, 1967-1982

Country of Origin	No. of Projects	Investment Commitment (US $ millions)
Japan	208	4,343.7
Hong Kong	134	1,193.0
Canada	5	863.3
United States	73	663.7
Netherlands	43	551.1
West Germany	21	295.0
Philippines	13	290.9
United Kingdom	46	286.7
Switzerland	20	247.1
Australia	35	226.8
India	11	167.4
Singapore	33	167.0
South Korea	16	163.7
Taiwan	4	129.6
Belgium	14	93.1
Panama	8	64.5
France	11	61.5
Malaysia	17	47.0
Denmark	4	34.3
Thailand	7	21.6
Italy	2	18.5
Lichtenstein	4	17.8
Brunei	4	16.8
Norway	2	15.4
Surinam	1	6.1
Bahamas	2	2.4
New Zealand	2	0.9
Liberia	2	0.9
Other countries	69	1,787.9
TOTAL	811	11,777.3

Source: Investment Coordinating Board, Indonesia: Development News, February 1983.

Table 9: Indonesia, Foreign Investment Approvals by Production Sector, 1967-1982

Production Sector	No. of Projects	Investment Commitment (US $ mill)	Investment Commitment % of Total
Agriculture	58	297.4	2.5
Forestry	64	669.6	5.7
Fisheries	28	159.2	1.4
Mining	10	1,339.4	11.4
Food Processing	45	301.8	2.6
Textiles	69	1,350.4	11.5
Wood Products	23	227.9	1.9
Paper Products	13	146.8	1.3
Chemicals	142	2,212.4	18.8
Non-ferrous Metals	34	621.3	5.3
Basic Metals	24	1,865.4	15.8
Metal Products	129	1,456.7	12.4
Other Manufacturing	21	50.8	0.4
Construction	69	148.1	1.3
Hotels	8	255.6	2.2
Real Estate	4	43.0	0.4
Transportation	17	138.8	1.2
Trade Services	5	32.1	0.3
Other Services	48	460.6	3.9
TOTAL	811	11,777.3	100.0

Source: Investment Coordinating Board, Indonesia Development News, February 1983.

Table 10: Indonesian Total Exports of Lumber Products

Export Volumes	1979	1980	1981	1982
(Mill. cubic meters)				
Raw logs	18.0	14.0	6.5	3.3
Sawn logs	1.3	1.1	1.3	1.4
Plywood	0.13	0.28	0.77	1.15
Combined Earnings				
(US $ billions)	1.9	1.9	1.1	0.85

Table 11: Selected Skilled Manpower Requirements in Indonesia to 1990

	Local Registered Availability 1980	Projected Requirement by 1990	Annual Required Addition 1980-90	Current Estimated Annual Net Supply
Engineers	15,000	69,000	5,500	1,400
Scientists	5,000	21,000	1,800	500
Agriculturalists	8,000	26,000	2,000	1,300
Accountants	1,600	11,000	900	200
Economists	5,000	16,000	1,200	300
Managers/Admin.	n.a.	337,000	(20,000+)	500

Bibliography on Canada-Indonesia Aid, Trade and Investment Relations

This bibliography represents a selection of recent works in English on Canadian foreign economic assistance, trade and investment, with particular reference to Indonesia and ASEAN. It does not include CIDA in-house documents relating to Canada-Indonesia trade, neither does it include general references on recent Indonesian economic development not directly relating to Canada-Indonesia aid, trade & investment.

The bibliography is organised into four parts:

- General Canadian Foreign Policy and Economic Assistance
- Canada-Indonesia and Canada-ASEAN Economic Relations
- Foreign Investment and Joint Ventures in Indonesia and ASEAN
- Other Country Relations and Economic Assistance to ASEAN

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14: THE DIVERSIFICATION STRATEGY OF THE ASEAN STATES: IMPLICATIONS FOR CANADIAN ECONOMIC TIES WITH SOUTHEAST ASIA

Donald Crone

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THE DIVERSIFICATION STRATEGY OF THE ASEAN STATES: IMPLICATIONS FOR CANADIAN ECONOMIC TIES WITH SOUTHEAST ASIA

Introduction

In recent years, Southeast Asia has become a focus of Canadian policy again, as highlighted by the tour of Prime Minister Pierre Trudeau in early 1983. But Southeast Asia is fundamentally different, both in the nature of Canadian interests and in the countries of interest.[1] Canada's role in the past as a participant in attempts to control the international effects of the Vietnamese Revolution was based on an interest in international security and peace. That interest has shifted to a search for partners in economic growth, and the country focus has changed accordingly to the survivors of decades of regional conflict--the members of the ASEAN: Indonesia, Malaysia, the Philippines, Singapore and Thailand.

A multitude of questions surround Canada's new role in Southeast Asia. Clearly, Canadian involvement did not emerge full-blown overnight. What are its precedents? It is also appropriate to question the importance of this region to Canada, especially given its rather recent discovery in the hierarchy of Canadian interests. It is also logical to question whether there is, in fact, an economic role for Canada to fill since the region has a long history of economic ties with European nations, the United States and, more recently, Japan. From the Southeast Asian perspective, are Canada's attentions likely to be reciprocated or shunned? Is there reason to pursue this path?

The short answer is yes. Cultivating a closer relationship with Southeast Asia is appropriate for Canada, still very possible, likely to be mutually rewarding, and in the perceived interests of the ASEAN states. The recent emergence of common mutual interests is the result of shifting experience and priorities by both Canada and the Southeast Asian nations as each has become more globally-oriented. At the base of present efforts to build a closer future relationship is a shared desire to diversify the structure of economic relations in order to dilute the overwhelming presence of a few large economic partners. The strategy is to reduce dependence through the tactic of incrementally building economic relations with alternative partners of opportunity. Canada and ASEAN have become partners of opportunity for each other, targets for future growth. The question is not whether present ties are important enough to justify upgrading relations, but whether future ties can be built to serve the longer-term interests of both Canada and the ASEAN states. That answer is much less sure as Canadian experience has not been supportive of positive results flowing from strategic economic thinking, at least if the 'Third Option' is to be a guide. Is there a 'Third Option' in the Third World?

The Importance of Southeast Asia

The members of ASEAN do not occupy a position of undisputed importance in the ranks of the world's nations, nor do they leap to mind when one considers the Pacific. Yet they have risen in prominence recently for their record of economic growth, first because of Singapore's membership in the "gang of four" (with South Korea, Taiwan and Hong Kong), and now as a group. During the 1970s, marked generally by international economic instability and stagnation in the industrialized countries, the ASEAN members set a torrid pace--real growth of GDP was 7.6 per cent for Indonesia, 7.8 per cent for Malaysia, 6.3 per cent for the Philippines, 8.5 per cent for Singapore, and 7.2 per cent for Thailand, compared to 3.9 per cent for Canada.[2] Even in 1981, a year of recession, their combined growth rate remained at 7.8 per cent, a result of substantial declines from 1980 for all but Thailand.[3] Trade growth over the decade was equally buoyant with export growth ranging from a low of 7 per cent for the Philippines to a high of 12 per cent for Singapore, and import growth spread mostly at the high end of a range from 3.4 per cent for the Philippines to 11.9 per cent for Indonesia, while Canada's exports and imports grew at 4.4 per cent and 6 per cent respectively.[4] While some Third World states such as Brazil grew at comparable rates, the recession of the past few years has resulted merely in downward adjustments in growth expectations, to the range of 5 per cent to 6 per cent for the ASEAN states, rather than insolvency as has been the case for many other states. This record of economic success has attracted attention to the ASEAN states, not just from Canada, and not entirely favourable, as illustrated by one Canadian newsmagazine report which highlighted the social repression in the region, labelling Trudeau's trip a "geopolitical litany of Amnesty International offenders."[5]

Still, success is its own reward and attraction. The region, with over ten times Canada's population (259 million in 1980) and just over two-thirds of Canada's GDP,[6] has become an important economic area. This was recognized in a recent address on behalf of the Department of External Affairs in Singapore:

> For Canada, a country which earns almost one-third of its gross national product through trade, ASEAN is an area of vital interest.
>
> Commercial relations between ASEAN and Canada, viewed against our global trading patterns, have achieved important dimensions. In the period between 1975 and 1980 two-way trade between Canada and ASEAN more than trebled from a level of $350 million to over $1 billion. The real growth rate of Canadian exports to ASEAN from 1975 to 1980 was 19 per cent.[7]

Diplomatic enthusiasm aside, the trade relationship needs to be put into perspective. Total trade with ASEAN has run between one-half of one per cent and one per cent of Canada's trade over the past decade; trade with Canada is similarly less than one per cent of ASEAN's trade. As global trade partners, Canada and ASEAN have maintained a rather minor relationship which is most notable for having kept pace with growth on both sides, and for having yielded a consistent surplus for Canada. The latter fact may be the most significant part of the trade relationship for Canadian interests--one aspect of the trade pattern over the decade is that earlier deficits with Malaysia and Singapore have been reversed, leaving surpluses for Canada with each ASEAN state. This situation opens Canada to pressures to balance the books, particularly by removing barriers to imports of cheaper manufactured goods from all of the ASEAN countries. Another change of some import in the pattern of trade has been a broadening among the ASEAN members. Due to longstanding ties through the Commonwealth, trade relations with Singapore and Malaysia constituted the bulk of trade with the region in 1970 (over 90 per cent of exports, for example). By 1980, the pattern was much more even with only Singapore having a disproportionate share, and some of that trade merely went through Singapore on the way to or from other ASEAN members. In the past decade, Canada has become a genuine trade partner with the region and not just with a few of its members.

While the above was intended to demonstrate that Canada and ASEAN are not major trade partners relative to their global patterns, it should not obscure the rapid growth of absolute trade volume that has been encouraged through economic diplomacy on both sides. The EDC, which helps finance both exports and imports of Canadian firms, has recently targeted ASEAN as a key area, increasing its lending to support trade with the region greatly in 1980 and 1981, and participating in joint finance arrangements with CIDA and multilateral banks such as the Asian Development Bank. While Canadian business managers are critical of the relative lack of interest subsidy of EDC funds, which they argue makes them less able to compete with other nations' suppliers, such support is a central aspect of Canada's economic diplomacy in the region, and it clearly makes Canadian participation in externally-financed trade arrangements more possible.

The 1970s were further marked by frequent exchanges of ministerial visits, including heads of state, and, toward the end of the decade, a regularization and institutionalization of economic relations. The tendency to broaden relations is captured by the contrast between

Trudeau's Commonwealth-related trips in 1970 and 1971 which included Singapore and Malaysia with a side trip to Indonesia, and the 1983 visit that included all of the ASEAN nations, even soon-to-be-independent Brunei. While Canadian interests also include regional peace and security, the economic element has been stressed. Following Trudeau's expressions of support in 1974 and 1976,[9] a series of trade missions in 1976, 1978 and 1980, and the January 1983 prime ministerial trip included an important trade element. The 1976 mission led by Don Jamieson was of primary importance, both in raising Canadian visibility and in securing increased sales; a telling critique of Trudeau's 1983 trip was that it failed at the latter goal.[10] In addition to federal missions, provincial trade and investment missions have become more frequent, especially from the West and Ontario. Still, officials in Industry, Trade and Commerce point out that gaining consistent ministerial attention and interest from a wider private sector constituency was difficult, despite such organizational ties as the Pacific Basin Economic Council (PBEC) and the Pacific Rim Opportunities Conferences. Southeast Asia was marginal to official and private Canadian concerns in the 1970s.

The minor Canadian role is also reflected in official diplomacy. While the "bilateral" ASEAN contacts with economic partners (known as "dialogues" at the outset and "forums" as they become settled) are often marked by economic conflict with the major powers, they have been low-key with Canada (included from 1977), even when concerned with economic issues.[11] Canadian participants in the meetings between the ASEAN foreign ministers and those of major partners in June 1982, were satisfied that they were not singled out for criticism, as were the major powers. This comfortable state of relations is partly due to having just cleared the table at the Third Dialogue session in Manila a month before and completing a new set of textile trade agreements, but also because of the lesser significance of Canada. The mechanisms for economic co-operation proceeded slowly since originating in 1977, culminating in the signing of an economic co-operation agreement only in 1981 and in the establishment of the ASEAN-Canada Joint Co-operation Committee in 1982, which regularizes relations between the ASEAN-Ottawa Committee (the ASEAN missions) and the Canadian government.[12] By the early 1980s, it was evident that both Canada and ASEAN were beginning to regard each other with more interest. Mark MacGuigan's assertion that Canadian-ASEAN relations were entering a "new phase" with the institutionalization of relations appears to be more than diplomatic rhetoric.[13]

As well, the Canadian relationship with ASEAN as an aid donor has entered a new phase. While Canada has never been a major source of Official Development Assistance compared to the economically larger nations,[14] Asia has been a significant focus of CIDA, receiving about 40 per cent of bilateral aid. The ASEAN countries are not large recipients of this aid ($31.5 million out of $233 million for Asia in 1980/81), nor is Canada proportionately a large donor. Most of it has gone to Indonesia in the form of "program" aid, while the other ASEAN countries are either becoming "too developed" (Singapore and Malaysia) or are considered a US preserve (Philippines).[15]

As can be seen in Table 2, the amounts of aid have not been insignificant, particularly when other indirect flows are accounted for, including support for the International Rice Research Institute in Los Banos, Philippines, and the International Development Research Centre in Singapore, contributions to the Asian Development Bank in Manila, small Missions Administered Funds in each country, and the ASEAN share of multilateral aid dispensed through United Nations agencies (about 40 per cent of the total). Particularly interesting in the pattern of aid are the recently re-established programs in Thailand (currently one of the more buoyant ASEAN economies) and new commitments to the Philippines resulting from Trudeau's trip, which may bring that country closer to the regional average. The growing importance of the ASEAN countries is apparent in the distribution of aid, with the ASEAN share of Asian aid increasing by a healthy margin, just a bit more than ASEAN's world share. Coming at the end of a decade of very rapid economic growth in Southeast Asia, the conclusion that economic interests have stimulated an increased aid flow is tempting. One US diplomat in Singapore noted rather plaintively the very effective use of CIDA-sponsored feasibility studies to get Canadian projects in the region--not that anyone has maintained that aid is detached from national interests, but rather, the flow of aid indicates a greater Canadian interest in ASEAN.

An extremely innovative attempt to build a wider official financial relationship with these countries has been developed in the form of the Industrial Cooperation Programme.[16] This program attempts to match Canadian businesses with counterparts in developing countries, the purpose being to facilitate exchanges of technology, largely in the form of joint ventures, with CIDA supporting feasibility studies and start-up costs for the Canadian partner. Although this has been a small budget item since 1976, a host of potential projects have been identified, a number of tours by industry groups have been sponsored, and two major conferences of Canadian and ASEAN private business managers have been run, CANEX '82 being the more recent in Singapore in June 1982. ASEAN is one pilot region for the program which both updates the nature of "aid", allowing financial flows to continue to countries with higher national incomes, and stimulates the flow of Canadian foreign investment, another CIDA goal. The program increases industrial linkages in mutually beneficial areas so that competitive sectors like textiles, and sensitive areas such as resource exploitation and defence, are avoided.

Over the long term, the Industrial Co-operation Programme will transform the nature of Canadian-ASEAN aid relations. Since the traditional aid flows are likely to fade out as the ASEAN countries' incomes grow, the benefits to the business community in the form of CIDA-sponsored consulting and exports of Canadian goods will also dwindle, leaving a reduced set of business linkages. Replacing ties that are contingent on a constant flow of aid dollars from CIDA with joint ventures in non-competitive industrial sectors, should result in more permanent interests on the part of Canadian business, and an enhanced position for Canada in the region as a more significant source of foreign investment and technology. This will supplement the regional aid programs in fisheries and forestry with industrial co-operation in each country and tie Canada more closely to a fast-growing region. However, a long-term strategy of co-operation with the middle-income developing countries[17] is of necessity as well as by design. Since CIDA mediates between essentially private actors on both ends, many false starts are to be expected, some from unrealistic expectations about the need for Canadian expertise and others from visions of impending riches leading to over-extension of solid projects. This has led to criticism as to the usefulness of the program. No quick change from a minor aid provider to a significant industrial partner should be expected.

Even with a planned increase in foreign-investment flow from Canada through industrial co-operation programs, Canada is not in danger of becoming a target of nationalist sentiment, as have the US and Japan. Canadian investment in the region is presently too small to be more than minimally visible, although some individual Canadian companies are very significant. While statistics on direct foreign investment are never terribly accurate, Table 3 gives the best available figures (these are gathered from the ASEAN countries) which can be taken as indicative of relative positions. Canada is a significant investor only in two of the countries, ranking third in Indonesia largely because the figures disguise the United States' position by excluding oil and including much US investment in "other countries", and ranking sixth in the Philippines just before the Republic of Nauru (and the smaller European countries). In most cases, Canadian interests are represented by just a few companies in any country, some of them endemic to the region such as Bata Shoes, and others being significant minerals corporations such as Inco and Alcan. Investment figures can be misleading by understating the role of Canadian business in areas that are either excluded from most statistics, such as banking, where Canada is well represented by most of its larger banks, or areas that do not require more than minimal investment, such as consulting services where large companies like Lavalan and many smaller companies are very active.

This pattern as a relatively minor investment source in Southeast Asia is consistent with the more general Canadian patterns.

Particularly in the 1970s, Canada moved from being mostly a host to corporations that invested outside of Canada as well as inside, to a more significant source of foreign investment in its own right, ranking fifth or sixth as a global source of investment behind the traditional dominant nations such as the United States, the United Kingdom, Japan, West Germany and France.[18] These same countries tend to rank ahead of Canada in Southeast Asia with Canada in the midst of the second-rank countries (the United States, Japan and the United Kingdom stand together as first-rank). Whether this order will last long is questionable. As Table 4 demonstrates, the developing countries of Asia have become much more significant recipients of Canadian investment, both globally and, more strikingly, among the developing countries. This is a significant change from the predominant focus of Canadian investment in Latin America and the Caribbean. Not all of this investment in Asia is in ASEAN but Statistics Canada reports that it is concentrated in Indonesia, the Philippines and India, supporting the figures reported in Table 3 above.

The growth in the early 1970s in Asian investment is, in itself, significant as it implies that Canada got in on the decade of rapid growth in the region. But the figures in Table 4 stop short of that decade and Table 3 implies that there was a continued rapid growth of Canadian investment (as much as tenfold) for the rest of the decade. Unless Canadian global investment also grew at that incredible rate, Asia in general and ASEAN in particular, have expanded to much more than the 15 per cent share of Canadian investment reflected in the 1977 figures. There is substantial evidence to point to this conclusion, some of which will emerge from examination of Canadian relations with each ASEAN country. There is no question, however, that ASEAN became a major new focus on Canadian investment activity during the decade of the 1970s.

The essential point to be made is that Canadian investment is not so small as to be insignificant, but nowhere near the exposure of the major industrial nations. More detail will be provided on each country, but in general, this position is advantageous. It allows a larger relationship to be built in mutually desired directions, such as those envisioned by the Industrial Cooperation Programme, from a base of established knowledge on the part of Canadian business managers of each country, without the burden of conflict inherited from nationalistic attacks on the countries that dominate foreign-investment flows. Especially relevant in this regard is the leading position of Canadian banks,[19] most of which moved into the ASEAN region for its importance as a new world financial centre; the few expectations that were held about being there to serve Canadian companies have not been overwhelmingly met. At the same time, they serve as an established infrastructure for expanded financial relations, and may comfort Canadian business managers who are contemplating joint ventures with local information and familiar logos.

In general, the importance of Southeast Asia as an economic partner is limited at present. Trade, aid and investment are at a new level in the global scheme for both Canada and ASEAN. The precedents for economic relations are meagre if one goes back more than a few years, but are growing rapidly. This attempt to situate Canadian-ASEAN relations in a larger perspective is not meant to downgrade their importance, but merely to point out that, in most cases, economic relations with ASEAN are a new development; this makes the subject worthy of analysis. The author's beginning investigations in 1979 were somewhat disappointing, but by 1982, the subject had come alive and was changing rapidly. Recent changes and the current state of relations in each country will illustrate this point.

The State of Relations with ASEAN[20]

As is apparent from the discussion thus far, Canadian involvement with Southeast Asia has changed from one based narrowly on Commonwealth and international security concerns to one based on economic considerations, which has meant a broadening and deepening of ties in the region. This change was rapid, especially in the latter half of the 1970s. The result is a shift from low to high visibility that has taken place largely without irritants. This aspect of change is perhaps best illustrated by the impressions of the author in talking to business and government leaders. In 1979, few Southeast Asians concerned themselves much with Canada, and comments to the effect that our country was merely an extension of the US economy and of no independent interest to them were common. By 1982, Canada was more often seen as a promising partner, the level of information about Canada had increased, frequently through personal contact, and general orientations were positive. This was accompanied by an increasing Canadian diplomatic presence. Staffs, especially consular, in the embassies and high commissions in the region, have been expanding which has facilitated and stimulated economic ties and the morale of Canadian diplomats has improved. Many of them feel that "their" region has been upgraded in the government's priorities and some express the notion that Southeast Asia is "the place to be" in the scheme of overseas postings.

Singapore

The latter comment was made in reference to Singapore, one of the countries with which Canada has traditional ties through the Commonwealth and which lead to a reputedly good personal relationship between Trudeau and Prime Minister Lee. In many ways, Singapore is the centre of ASEAN, particularly in regard to trade, manufacturing, petroleum processing and finance, and is by far the most livable city in Southeast Asia for expatriates, including some 500 Canadians. With the exception of manufacturing, Canadian ties are concentrated in Singapore's specialty areas.

Singapore is consistently Canada's largest trade partner in ASEAN, but not as a final destination. Appropriate to Singapore's entrepôt role, potash as the largest import commodity and raw rubber as the largest export item, are both simply housed in Singapore on the way from their origin to final destination. This is also true for many other goods such as machinery and newsprint. Some trade practices, such as the use of the US market as a source of supply by Canadian traders for parts of the year, have reinforced the Asian image of Canada's lack of identity in North America. Poultry, for example, comes from Vancouver in summer and Los Angeles in winter. Canadians have only recently realized the centrality of Singapore to

Asian trade and are beginning to shift it from Hong Kong, especially with persistent economic stagnation in their traditional markets of the United States and Europe, a stark contrast to continued expansion in Southeast Asia. Trade is also the one area of friction between Singapore and Canada. Restrictions on textile imports, first imposed in 1976, were an issue requiring high-level attention until negotiated quotas were set in 1979 and later renewed. While only a small part of trade is affected from the Canadian perspective, any such restrictions are resented in a country like Singapore that is trying to expand exports. At present, Singapore trade officials mention the difficulty of using Canada's system of trade preferences, and their desire for regional production to be eligible.[21] Singapore's rapid rate of economic development is likely to make it a much more important trade partner in the future, and in its own right, not simply as a regional centre, as recent Canadian interest and success in selling computer technology and the constant parade of trade missions demonstrate.

Expansion of trade is only in a minor way the result of the presence of Canadian businesses in Singapore. While there are several dozen sales offices and hundreds of local agents for Canadian products, there have never been more than minor manufacturing operations in Singapore, as the investment statistics in Table 3 indicate. Because Singapore is a centre for regional trade and finance, many Canadian businesses in other parts of ASEAN, like Alcan, Northern Telcom and Inco, have offices in Singapore that conduct trade relations for their production centres elsewhere. The major Canadian presence is in Singapore's dominant petroleum and services sectors, both of which serve the region, not the Republic.

Petroleum is Singapore's lifeblood, not only as the major export and investment sector, but also as the basic link to the region and the world. As the world's third largest refining centre, Singapore handles a large part of the region's oil output and provides a large share of petroleum industry services. Canadian companies are well-entrenched, with several oil companies (Asamara, Bow Valley), a number of drilling contractors (Bawden, Westburn), parts suppliers and service companies (Okanagan Helicopter) located there. Together, they likely constitute the majority of Canadian enterprises in the country.[22] This will probably remain true for the next few years, as both the region's petroleum business and Singapore's refining capacity are expanding, and constant contact between Canadian companies and governments and regional industry gatherings indicate continued interest and involvement, certainly as long as the North American petroleum industry is slack.

Financial services, especially banking, is the most rapidly growing sector in Singapore, responding largely to the boom in the offshore "Asia dollar" market in the late 1970s. This is a heavily transnational business, with well over 100 foreign branch banks in Singapore, which serves as the largest centre for finance in all of Asia. While Canadian banks are only a small part of the total industry, all the major ones are there--Montreal, Imperial, Scotia, Royal and Toronto-Dominion--and several also cover Indonesia and Malaysia from these offices. ASEAN is an important locale for them and several, notably Montreal with its Asia-Pacific headquarters in Singapore, are significant in the $85 billion dollar offshore financial market.[23] None are there to serve, or follow, Canadian businesses as they were established in the early 1970s when little other Canadian presence was evident; they argue that they still couldn't live strictly on Canadian business despite its recent growth. The regional market for offshore loans, the presence of other major banks, and a link in worldwide coverage provide the incentives, and syndicated loans and occasional "lead" roles in private commercial deals provide the profits, although less in the last few years due to relatively low "spreads" (the charge above the cost of funds) charged to Asian borrowers. The bankers are the prominent Canadians in Singapore and it was probably no accident that the recently formed Canadian-Singapore Business Group appointed one of the managing directors to its chair. The banks provide a solid base for the future expansion of Canadian economic interests in Southeast Asia and they hope to facilitate that growth.

Other economic ties with Singapore are relatively insignificant. While the IDRC is located there, it serves the region primarily, and there is no important aid flow to Singapore, despite its reclassification from more-to-less developed, to avoid discrimination or political repercussions. The major area for expansion of Canadian interests is in manufacturing, especially such high technology fields as telecommunications, aerospace and transportation. The Singaporean government is trying to recruit in these industries, particularly in smaller companies. As it stands, Canada's economic relations with Singapore are thriving and in the most dynamic sectors, all of which is facilitated by that Republic's philosophy of internationalization.

Malaysia

Across the causeway, in Malaysia, both the business climate and the Canadian presence are different. The government has been involved in a decade-long attempt to restructure the economy, especially to increase domestic indigenous ownership so that both the level of nationalism and the role of government in the economy are the highest in ASEAN. More recently, the applicability of the Western cultural ethos for Malaysia's development has been questioned, resulting in the "Look East" policy--applying Asian experience, in the words of the Deputy Prime Minister, "to protect us from the cold North Wind."[24] This has not resulted in delinking from foreign economic ties, but a more careful evaluation of national benefit and closer government control. Still, the long and relatively comfortable Commonwealth connection has not resulted in Canadian economic ties as strong as one would expect. While cultural ties are strong, especially recently with 8,000 Malaysian students in Canada and many refugees (the so-called "boat people") also being taken in, economic ties are not as robust.

The official figures show Canadian trade with Malaysia to be the least in ASEAN, although by a narrow margin, but that is not a fair representation. Much of Malaysia's trade goes through Singapore, especially exports of rubber (the main item to Canada), and imports from Canada of forestry equipment and potash fertilizer. Malaysia buys one-half of its potash from Saskatchewan for agriculture schemes; this shows as trade with Singapore. Generally, Malaysia is a good customer for Canadian raw materials such as aluminum, steel, zinc, asbestos and newsprint, with some manufactured goods like telephone equipment and aircraft parts selling as well. Canada buys, almost entirely, Malaysia's commodities such as palm oil, rubber and lumber. This has been a problem as Malaysia has been expanding clothing exports and recently ran up against Canadian quotas; there is now a long-term textile agreement. However, this is a small problem and, overall, Canadian trade relations with Malaysia are smooth, especially because Canada has signed international tin and rubber agreements to help stabilize the prices of Malaysia's major exports. To some degree, Malaysia and Canada, especially the Western provinces, are competitors in the Pacific market as both export timber products. Recent Japanese purchases for their housing market that have emphasized softwoods from British Columbia over previous imports of Southeast Asian hardwoods have adversely affected Malaysian exports of raw lumber. But this plays well with Malaysian desires to get away from less-processed lumber exports and has not resulted in animosity.[25] It could, in fact, be converted into co-operation, either to raise the level of processing in the Pacific market or to provide the technology through joint ventures.

In contrast to Singapore, Canadian business in Malaysia does visibly influence the trade pattern. Two manufacturing concerns in Malaysia, Northern Telecom and Alcom (an Alcan subsidiary), are apparent on the trade balance. The first results in an almost balanced trade of telephone apparatus, worth about $5 million in 1980 (not all Telecom), and the second is a major part of about $18 million of aluminum exports for Canada. The aluminum example is fascinating as a study of the integration of the Pacific economy--some bauxite is mined in Malaysia by one subsidiary, shipped to Japan for refining, then to Kitimat for smelting in another subsidiary that returns ingots to Malaysia through Hong Kong for the major local process of extrusion into parts, some of which are exported to Singapore. No wonder that some developing countries despair when they try to control foreign firms! (Alcan has good relations with Malaysia, and has complied with a variety of government directives with few problems.)

Because of government preferences and directives, almost none of the Canadian businesses in Malaysia are wholly foreign-owned. Some such as Bata Shoes are indistinguishable from local companies and major forces in the local market. In other sectors like banking, government regulation is cumbersome for foreign enterprise; some government officials are concerned that foreign countries may use their banks for political influence, so that even indigenized banks feel very visible. Scotiabank, for example, was the last foreign bank allowed to open a branch in Malaysia in 1973 and, at present, is the only Canadian bank running its own operation. Others have a minority position in Malaysian banks which has occasionally embroiled them in conflict between the Malay and Chinese communities. Even some of the Canadian consulting firms (engineering, computer software and tourism) have felt pressure to become indigenized in order to retain the ability to get contracts. At the same time, the regulatory atmosphere is not inhibiting expansion and new projects. All of the Canadian manufacturing companies are undertaking major expansions; a new venture in carpet manufacture started recently with majority local ownership. Judging from the experience of these companies, there does not appear to be any necessity for government regulation to damage the ability of foreign joint ventures to operate effectively.

Malaysia is an excellent example of the use of foreign aid funds to stimulate Canadian business. While CIDA funding is now dwindling from earlier higher levels, a great deal of energy consulting was provided that kept at least one major firm afloat in hydroelectric projects. Canada has also sponsored a mineral resources survey with the hopes that some of the possibilities identified will use Canadian firms. Other small programs, such as the Mission Administered Fund and Canadian Executive Service Overseas, have kept Canada in good local press. The Industrial Cooperation Programme has been less successful--many possible projects were identified; only one was started and it collapsed.

The last few years make it certain that Malaysia will not remain a minor economic partner. Substantial growth in all aspects of relations with Canada is evident, including the acquisition of a

Canadian business by Sime Darby, the Malaysian multinational.[26] The pace of Malaysian public relations in Canada and of missions going both ways seeking increased trade and investment keeps diplomats at both ends booked solid. "Solid" seems to describe the future economic relationship as well.

Indonesia

Canada also has a long and traditional relationship with Indonesia, based to a large degree on aid. Canada is a member of the Intergovernmental Group on Indonesia (IGGI), the consortium of aid-giving countries, and has channeled this way a considerable flow of finance to a variety of projects, largely in transportation. Current projects building roads and coal transportation facilities for the Bukit Asam mine in Sumatra continue this tradition. A significant new area has been staked out with the Resource Evaluation Aerial Photography project that will map and assess natural resources for future development. All of these projects have led to considerable activity by Canadian consulting firms, probably to the maximum degree desired by the Indonesian government, which tries to balance such contracts among the major countries. The extension of CIDA funds is particularly welcome now as the Indonesian government is trying to maintain economic growth despite revenue shortfalls due to petroleum price declines and the gradual reduction of development assistance.[27] Large increases in aid (to $26 million in 1982) are a cornerstone of economic relations with Indonesia.

Trade relations are not so favourable. Largely because Canada does not buy oil, Indonesia's major export, the trade balance runs consistently above a four-to-one Canadian surplus, a situation the Canadian ambassador finds slightly embarrassing.[28] The problem is largely Indonesia's, as exports are not well diversified, which makes it difficult to take advantage of opportunities that exist. For example, Indonesia has never come close to meeting its allowed quota of clothing exports to Canada--in fact the balance of trade in textiles also runs in Canada's favour. This is the source of Indonesia's controversial "counter-purchase" law that requires importers to find markets for Indonesian exports in a similar amount, essentially trying to use foreign companies as marketing agents to balance trade. But the prospects of de Havilland, for example, taking $30 million extra in rubber, palm oil or pepper to compensate for the DASH aircraft are slim.

Prospects for Canadian foreign investment, on the other hand, are more robust, at least if we believe Trudeau's assertion that there is a "natural fit" between Indonesian resources and Canadian capabilities.[29] The actual Canadian presence is somewhat more modest, limited to just a few companies. Two of these are in oil, which is Indonesia's specialty. Hudson's Bay recently joined Asamara as a small producer in the Malacca Strait off Sumatra; neither are major producers and thus will not be affected by the government's recent tightening of terms for foreign firms in the oil sector.[30] Alcan and Bata both have production facilities, with the former contributing to healthy imports from Canada of aluminum. The US banks came to Indonesia early and got full licences, but several Canadian banks have representative offices (of their Singapore branches) elsewhere in the region; they handle the local business of Canadian investors, but couldn't survive on that alone.

The clear contrast to these relatively modest operations is Inco, one of Indonesia's major resource companies. The project, which got in under Indonesia's more favourable "second generation" mining contract in 1968, includes towns, a dam, roads and pipelines as well as the mining site, all carved out of heavy jungle in central Sulawesi. Communications is provided by a private line on Palapa, Indonesia's communications satellite. The mine, financed in part by six governments and owned wholly by Inco with a small Japanese stake, relies on the Japanese market and so does not produce for Indonesia. Processed nickel is imported, largely from Canada, for local use. Targets for making a profit by 1985 have been set back by the soft world economy but low labour costs keep it competitive and producing at low capacity levels, while Canadian operations are cut back and Guatemalan ones closed.

This kind of export project, which is highly desired by some

Indonesian factions to keep the lagging flow of foreign investment up, is also a clear target for nationalism. Slow indigenization combined with a flagging local economy have reportedly led to a new surge of criticism, and calls for a halt in expansion of foreign investment by such groups as the Indonesian Chamber of Commerce.[31] While most Canadian firms comply with employment targets (some have only a handful of expatriates), all of the ones mentioned here are foreign-owned by a heavy majority--a clear contrast to the situation in Malaysia as well as Indonesian government preferences. This vulnerability, combined with the difficulty Canadians have with operating in a business climate that often includes extensive bureaucratic delays (one British Columbia plywood firm has reportedly been negotiating entry for the last three years) and the need to learn the protocol of side-payments (still widely reported necessary), is not likely to lead to a vast upsurge of Canadian investment in the near future. These factors and the difficulty in keeping trade balanced do not forecast significant increases in Canadian economic ties. Government-to-government aid projects are likely to remain the most dynamic sector.

Thailand

Canadian relations with Thailand are similarly weighted toward aid flows rather than investment or balanced trade growth. If anything, the bureaucratic maze in Thailand is more complex than in Indonesia as it involves behind-the-scenes factional politics in addition to the necessity for personal connections to accomplish simple tasks. Because of the appearance of domestic instability (not necessarily the reality) and international insecurity on the Cambodian border, the Thai economy has been somewhat neglected, despite its record of high growth and resilience to difficult external conditions.

CIDA's program in Thailand has been an important source of funds that are welcomed for their contribution to Thailand's traditional financial problems. Canada's relatively neutral political image, however, was a large factor in increasing Thai enthusiasm for the major renewal of the aid program in 1982 that will include rural social development as well as mineral and energy development in funding of up to $10 million a year. The favourable political image of Canada is illustrated by the inclusion in this package of several Canadian experts as advisers in key Thai government ministries, something that would not be asked of Japan or the United States due to sensitivity to big-power dominance. The same is likely to be true of Thailand's resource survey, an area of traditional Canadian involvement. All of the CIDA programs are sure to increase the role of Canadian consultants, many of whom have already established themselves in Thailand with multilateral bank contracts, especially in energy sectors. The prospects of greater Thai energy resources has also resulted in close interest by Alberta, and in some extension of provincial aid, scholarships and numerous visits back and forth. The extensive aid program is seen by the Thai government as an opportunity to build an economic relationship through assistance and technology that is not tainted by big power pressures. It is the key to the growth of Canadian relations with Thailand.

There has also been substantial growth in trade relations. Canada exports a variety of products to Thailand, mostly lightly-processed resources from the Western provinces, but also aircraft and communications equipment, including a new Landsat receiving station. Some of these, like zinc, will be replaced by Thai projects in the near future,[32] while others such as fertilizers will most likely grow. The balance of trade is heavily in Canada's favour, a general problem in Thailand's trade which has become the source of policies designed to correct the imbalance. Not only does Thailand's current national plan target the issue, but the opening of a commercial office in Canada is designed to help Thai exporters, and official trade visits have become more frequent.[33] There is a textile agreement between Canada and Thailand, but it does not significantly restrain trade. Clothing is one of Thailand's major exports to Canada but that is more than balanced by Canadian fibre exports to Thailand. Thailand has taken whatever action it could with other trade partners to balance the books, and this is likely to become the major source of friction with Canada if the present imbalance continues to grow.

Canadian business in Thailand is sparce and the prospects for expansion are unclear. Bata Shoe and Alcan are the only two manufacturing links; the latter is a wholly Canadian-owned extrusion plant that processes aluminum from Canada (a major export to Thailand) for markets in the Middle East. A Canadian oil firm is a partner in one of Thailand's new natural gas fields and may be allowed to export liquified natural gas which would require large investments. And four of the five major Canadian banks now have offices in Bangkok, due to a recent expansion. But Thailand is torn between rapid expansion and rationalization of its industrial sectors, and nationalistic fear of large growth in foreign investment. The growth is planned and large projects are on the books that would include government investments for the first time. But the architect of that policy, former Deputy Prime Minister Boonchu Rojanastien, has come under fire from more nationalistic elements of the bureaucracy and the dominantly small-business commercial sector;[34] and the major opposition group in the army, which mounted the most recent coup attempt, is very nationalistic. Despite the active promotion of closer government-to-government relations through aid, and more private sector links between the Association of Thai Industries and the Canadian Manufacturers' Association, a rapid expansion of foreign investment in Thailand will be contingent on domestic politics in that country. Economic relations between Canada and Thailand are expanding, but rely largely on increased links generated through foreign aid.

Philippines

The Philippines is designated Canada's "contact nation" in ASEAN, the point of co-ordination with the region. This was not done because of the importance of economic links between Canada and the Philippines which were almost non-existent in the late 1960s. In fact, through the late 1970s Canadian diplomats were complaining that Canada's economic role, which had grown considerably, was not recognized by Filipinos. Until recently, Canada has been perceived in the Philippines as simply one part of North America, and therefore overwhelmed by the traditional US position. This is slowly changing, especially with a growing community of Filipinos now living in Canada, some of whom provide economic as well as personal links between the two countries.

In contrast to relations with the other ASEAN nations, aid is not a major component of Canada's involvement in the Philippines. The only large aid project is the Integrated Agricultural Development Project in Cagayan Valley, which seeks to restructure a monocrop rice region through crop diversification and infrastructure building, especially co-operatives and village associations,[35] although several other projects were discussed during Trudeau's visit. Other support is provided indirectly through the International Development Resource Centre in Singapore and funding of the International Rice Research Institute. CIDA's Industrial Cooperation Programme has sponsored a number of studies of potential co-operative ventures with some success but, overall, the aid relationship has been the smallest in Southeast Asia.

The lack of CIDA projects has not restrained the growth of trade with the Philippines, and Canadian exports will receive a major boost as the recently ratified nuclear agreement is implemented, sending uranium and a Candu reactor to Manila.[36] A $13 million purchase of tuna boats from British Columbia with EDC support will also help keep the trade balance in Canada's favour, as will an EDC line of credit to the Development Bank of the Philippines.

Philippine exports to Canada were supplemented in 1981 by a new venture in tuna processing, which is a joint partnership with minority Canadian holdings in the southern Philippines. Mar Fishing, with participation from B.C. Packers and Plaer Development, was designed for export back to Canada where the packing industry was failing. But when Starkist bought out the last local packer in B.C. and the government raised tariffs on tuna, the rationale for the project weakened; it is uncertain whether it will survive despite almost $5 million of tuna shipments back to Canada in its first year. The incongruity of an overseas Canadian venture competing with a protected US venture in Canada is, perhaps, one of the smaller reasons why Canadian companies hesitate to establish themselves in Southeast Asia.

This is not typical, however, and Canadian investments in the Philippines have grown rapidly. From a base of near zero in 1970, Canada has become one of the more important investing countries after the United States, Japan and Hong Kong. Canadian companies have small shares in several copper and nickel mining ventures and appear to be extending into coal mining. Husky Oil has been one of the largest participants in the Philippines' hopeful search for petroleum, and several other Canadian companies, including Falconbridge and Okanagan Helicopter, are involved in the natural resources areas. Other manufacturing firms such as Pillsbury reinforce the image of Canada as an intermediary for US multinationals. Canadian service industries such as in insurance and banking also have a place; Scotiabank, for example, has its Pacific Regional Office in Manila, and Montreal and Royal both had offices there, although the latter has withdrawn. The International Spiritual Centre, with Canadian investment and donations, runs a Philippine-style healing centre, providing a large flow of Canadian visitors to northern Luzon. And numerous Canadian Filipinos have investments in a variety of small industrial and service ventures. Overall, the Canadian investment role in the Philippines is likely to expand further, especially if Canadians are successful in their attempts to participate in the 11 large industrial projects slated for the Philippines in the next decade.[37]

At the same time, a major limitation of further economic linkages is the difficulty that the Philippines is having in adjusting to the uncertain international economy that has led to severe financial problems, compounded by uncertain domestic stability as opposition to the Marcos regime continues to build. Building up the role of CIDA and keeping a low profile in business ventures would seem essential to the future health of economic relations with the Philippines.

The Future of Relations with ASEAN

As is evident in the foregoing, economic relations with the ASEAN nations have been expanding rapidly, from a small base to a significant position in most of the countries. This has been assisted by a higher political priority placed on the region, increases in the extension of economic aid through CIDA, and an increasing interest on the part of Canadians in overseas expansion, both for trade and for production. The diplomatic presence of Canada has been expanded to meet the larger load, and further expansion is planned, especially in commercial representation, for most of the ASEAN countries.

While some of the reasons for this expansion lies in growing Canadian internationalism, a large part is more directly the result of changing priorities in the ASEAN countries themselves. During the 1970s, a doctrine emerged among the ASEAN nations that stresses a wide diversification of economic relations, especially in trade and investment.[38] This geoeconomic doctrine is designed to reduce the degree of dependence on the largest economic powers through expansion of relations with smaller countries, mostly European, but also East Asian and socialist. There is no desire to reduce the international orientation of the ASEAN economies, but merely to trade and acquire technology from politically less-threatening nations, including other Third World states. It also comes to bear in the selection of consultants, the allocation of portions of large projects, and the nations that are chosen for promotional efforts. It is this element of Southeast Asia policy that makes the expansion of relations with Canada a longer-term prospect.

This preference of the ASEAN countries is the base for future relations. It was evident to Canadian decision-makers as early as 1976, and is reflected explicitly in the trade mission led by Don Jamieson, the major Canadian effort to expand trade relations in the 1970s.[39] The report of that mission also recognized that this built the basis for mutual objectives, in line with Canadian desires to diversify foreign relations and enhance the Pacific dimension. Southeast Asia and Canada both share an interest in a "Third Option".

While the ASEAN countries may now be less important for Canada than Japan or the other East Asian countries, they are an important part of any effort to shift Canada's orientation to the Pacific. Most aspects of relations with these countries support further expansion, but trends toward regular attention at high governmental levels and institutionalization of both public and private linkages, such as the new Asia Pacific Foundation in Vancouver, will have to continue unabated if the progress made in the last few years is not to be wasted, as has happened previously. Canada is a particularly desirable partner for the ASEAN countries, and ASEAN for Canada. Each can meet its economic and political goals through co-operation with the other, a rare combination for smaller industrial countries like Canada and developing countries like the ASEAN members.

Notes

1. For previous surveys of Canada's relations with Southeast Asia, see: Paul Bridle, "Canada and the Intenational Commissions in Indochina, 1954-1972," and Lorne Kavic, "Canada and the Security of Southeast Asia," in M.W. Zacher and R.S. Milne, eds., Conflict and Stability in Southeast Asia (Garden City, N.Y.: Doubleday, 1974); David Van Praagh, "Canada and Southeast Asia," in P.V. Lyon and T.Y. Ismael, eds., Canada and the Third World (Toronto: Macmillan, 1976).
2. World Development Report, 1982, Table 2 (Washington, D.C.: IBRD, 1982), pp. 112-3.
3. Business Times (Malaysia), 15 January 1982.
4. World Development Report, Table 8, pp. 124-5.
5. Macleans, 24 January 1983, p. 10.
6. In 1980 (US dollars):

   Indonesia - $69,800 million
   Malaysia - $23,600 million
   Philippines - $35,490 million
   Singapore - $10,480 million
   Thailand - $33,450 million
   Canada -$253,350 million

   (Source: World Development Report, 1982, 114-5.)
7. "Growing Canada-ASEAN Relations", Dept. of External Affairs, Canada, Statements and Speeches 82/19 (Delivered by Mr. W.T. Delworth in Singapore, 21 June 1982, on behalf of Secretary of State for External Affairs), pp. 3 and 2.

8. See Export Development Corporation, Statistical Review 1981 (Ottawa: EDC, 1981); "Canada-ASEAN", (Singapore: Canadian High Commission, 1982).

9. In a letter to the Far Eastern Economic Review in December 1974 and in statements in Tokyo in 1976 in New Nation (Singapore) 25 October 1976.

10. The Jamieson trip reported $10 million in on-the-spot sales as well as government-to-government financial agreements. See Department of Industry, Trade and Commerce, Canada, "Report of the Ministerial Trade Development Mission to Southeast Asia", (Ottawa: Industry, Trade and Commerce, 1976); domestic reaction to Trudeau's trip is from Far Eastern Economic Review, 17 February 1983, p. 50.

11. See, for example, A. Douglas Small, "The Developing Dialogue Between Canada and ASEAN", International Perspectives (March/April 1978), pp. 28-31.

12. See Ramon V. del Rosario, "Relations with Southeast Asia Blossom under ASEAN", Canadian Business Review (Winter 1982), pp. 31-4.

13. Statements and Speeches 82/18, 17 June 1982.

14. According to OECD statistics, Canada has provided from 4-6 per cent of the total: World Development Report, Table 16, p. 140.

15. In 1980/81 for example, Indonesia received $18 million, Thailand $11 million, Malaysia $2.2 million and the Philippines $240,000; See CIDA Review 1980/81, Canadians in the Third World, Statistical Annex. For comparative statistics, see OECD, Financial Flows to Developing Countries (Paris: OEDC, annual).

16. For background, see Canadian International Development Agency (CIDA), Industrial Cooperation With Developing Countries, Report on the International Consultation on Industrial Cooperation convened by CIDA, 2-4 March 1977. (Ottawa: CIDA, 1977). Much of the following is based on author interviews at CIDA (May 1980) and in ASEAN (Summers, 1979 and 1982).

17. See CIDA, "Strategy for International Development Cooperation

1975-1980", (Ottawa, 1975), 20.

18. See Economic Council of Canada, For a Common Future: A Study of Canada's Relations with Developing Countries (Ottawa: ECC, 1978), 75-79; Statistics Canada, Balance of Payments Division, Canada's International Investment Position/Bilan canadien des investissements internationaux, (Ottawa: Statistics Canada, annual).
19. Far Eastern Economic Review, 26 June 1981, pp. 46-7.
20. Unless otherwise noted, the sources for this section are the author's interviews with Canadian diplomatic personnel, Canadian business managers and ASEAN government officials, and materials provided by them. "CANADA-ASEAN", a publication of the Canadian High Commission in Singapore is a useful summary of details.
21. "Cumulative rules of origin", would allow goods manufactured in stages in several ASEAN countries to be qualified for the General System of Preferences' duty reductions. See Business Times, 7 June 1982.
22. "The Petroleum Industry in Southeast Asia", (Singapore: Canadian High Commission, 1981).
23. See Far Eastern Economic Review, 26 June 1981, pp. 46-7; The Economist, 13 November 1982, p. 25.
24. New Straits Times, 24 June 1982.
25. Business Times (Malaysia), 4 January 1982.
26. New York Times, 26 January 1982.
27. World Bank, Indonesia: Financial Resources and Human Development in the Eighties (Washington, D.C.: World Bank/IDRC 1982); Far Eastern Economic Review, 20 January 1983, pp. 44-6.
28. Comments in Far Eastern Economic Review, 26 June 1981, p. 61.
29. Indonesia Development News, 6/5 (January 1983).
30. New York Times, 11 October 1982.
31. Reports in Business Asia, 11 February 1983, and Institutional Investor, January 1983, pp. 115-26.
32. The zinc refinery under construction will also displace Canadian

exports to other countries in the region. Economic Times (Bangkok), 29 June 1982.

33. Vancouver Province, 16 June 1980; 5th National Economic and Social Development Plan, 1982-86 (Bangkok: NESB 1982), 31-3.

34. Economic Times (Bangkok), 29 June 1982.

35. 1981 Philippine Development Report (Manila: National Economic and Development Authority, 1982), 128.

36. Far Eastern Economic Review, 27 January 1983, p. 8; Globe and Mail, 20 June 1982.

37. 1981 Philippine Development Report, 69-73.

38. Donald K. Crone, The ASEAN States: Coping with Dependence (New York: Praeger, 1983).

39. "Report of the Ministerial Trade Mission to Southeast Asia", 1-3.

Table 1: Canadian Trade with ASEAN (in millions of US $)

	1970 amt/bal	1975 amt/bal	1980 amt/bal
Indonesia			
exports	18 +17	66 +52	137 +112
imports	.5	14	25
Malaysia			
exports	15	25	82 +11
imports	33 -18	56 -31	71
Philippines			
exports	32 +28	50 +28	94 +7
imports	4	22	87
Singapore			
exports	12	36	171 +43
imports	19 -7	46 -10	128
Thailand			
exports	10 +9	22 +16	119 +98
imports	.8	6	21
ASEAN			
exports	87 +30	199 +55	603 +271
imports	57	144	332

Source: International Monetary Fund, Directions of Trade Statistics, Yearbook (various years).

Table 2: Canadian Bilateral Aid to ASEAN (in millions of Cdn. $)

	1978/79	1979/80	1980/81	% of country's total
Indonesia	12.7	11.8	17.9	1.7
Malaysia	2.4	1.8	2.2	0.9
Philippines	.3	.4	.2	0.1
Thailand	2.5	6.8	11.1	2.6
TOTAL	17.9	20.8	31.4	
Asia	227.0	234.6	223.3	
ASEAN/Asia (%)	7.9	8.9	14.1	
TOTAL (world)	554.4	598.8	581.5	

Sources: CIDA, "Canadians in the Third World," CIDA Review 1980-81 Statistical Annex.
OECD, Financial Flows to Developing Countries, 1981.

Table 3: Canadian Investment in ASEAN (in millions of Cdn. $)

		Amount	Canadian % of total foreign
Indonesia:	1976	94.8	1.5
	1981	1035.6	8.2
Malaysia:	1975	5.0	1.0
	1979	5.76	0.8
Philippines:	1975	10.8	2.4
	1981	54.0	2.8
Singapore:	1975	5.2	0.3
	1978	6.7	0.2

Sources: Economic Development Board, Singapore.
Investment Coordinating Agency, Indonesia.
Malaysian Industrial Development Authority.
Central Bank, Republic of the Philippines.
Thai figures not available.

Table 4: Canadian-Controlled Foreign Investment (in million of Cdn. $ by area)

	1977 $/%	1972 $/%	1968 $/%
Asia (except Japan)	428/3.7	63/1.2	14/0.5
Developing Countries	2828/24.8	1361/25.0	376/12.4
Asia's % of Developing Countries	15.1	4.6	3.7
TOTAL	$ 11,407	$ 5,436	$ 3,028

Source: Statistics Canada, "Canada's International Investment Position" (Ottawa: various years), Table 4. Further breakdown is not available due to confidentiality rules.

15: CHINA'S "OPEN DOOR" POLICY

Samuel P.S. Ho
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CHINA'S "OPEN DOOR" POLICY

Introduction

Since the death of Mao Zedong and the purge of the Gang of Four in 1976, the phrase kaifang zhengce (usually translated as "an open door policy") has appeared with increasing frequency in Chinese commentaries and policy pronouncements. Not surprisingly, this new policy has caused considerable controversy. Foreign businessmen have generally asked, "Will China really open the door and keep it open?" But Chinese discussions have naturally tended to ask, "Should China pursue a more open policy? And if so, on what terms?"

The broad outlines of this new policy began to emerge during 1977 and 1978, closely paralleling the second political rehabilitation of Deng Xiaoping. But as the Chinese themselves put it, the "historic turning point" for the "open door" policy came in December 1978 at the Third Plenary Session of the 11th Central Committee of the Party.[1] The communiqué of the Third Plenum announced that China would be "actively expanding economic co-operation on terms of equality and mutual benefit with other countries" and would be "striving to adopt the world's advanced technologies and equipment". Within a few days of the Third Plenum, Li Xiannian told a group of foreign visitors that, provided China's sovereignty was not impaired, his country was prepared to accept not just technology, but investment as well, from the developed countries of the capitalist world. On 8

July 1979, China promulgated its new "Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment", thereby taking a major symbolic step toward confirming and implementing the "open door" policy.

Only four short years have passed since the Third Plenum, but much has happened in that time. The intent of this paper is to examine China's new policy towards technology transfer and foreign investment--not merely to describe the genesis of the "open door" policy, but to place it in the context of China's development strategy, to discuss how it has been influenced by lessons China learned from its earlier efforts to acquire foreign technology, and to briefly review what the policy has achieved to date.

China's Development Strategy and Economic Program

The "open door" is an integral part of China's new development strategy and is, of course, only one of the many policy shifts that have occurred in China since 1976. Its implications therefore are best understood in the context of why the Chinese believe a new development strategy is necessary. The brief discussion that follows focuses on, but a few selective strands of recent Chinese history--i.e., those that have especially influenced China's economic policy and development strategy.

It is useful to think of the policy shifts in China since 1976 as the most recent development in a continuing debate that dates back to at least the mid-1950s. The debate centres on three fundamental questions:

- Should China give first priority to the development of productive forces (i.e., economic construction) or to the transformation of production relations (i.e.,the development of socialism)?[2]
- What development strategy would give China the most rapid economic growth?
- What sort of economic management system is most appropriate for China?

How a Marxist answers the first question depends critically on his analysis of conditions in China. Those who believe that China's main problem is the lack of means of production would argue for assigning first priority to the development of production forces. However, those who believe that the development of productive forces is hindered by existing production relations in China will want to give first priority to the building of socialism in the belief that, once production relations are fully transformed, large development of productive forces will follow.

The question regarding development strategy refers to a debate between those who favour an unbalanced growth strategy (high investment rates, the construction of new plants and facilities on a large scale, and the priority allocation of investment to the capital goods sector) and those who favour a balanced growth strategy. Those who support unbalanced growth do so generally because they subscribe to the following views:

- The rate of economic growth is determined by the size of the capital goods sector. Since heavy industry in China is small and underdeveloped, increased economic growth can be attained only by rapidly expanding the capital goods sector.
- Economic sectors are in competition with one another so that the capital goods sector can be expanded only at the sacrifice of the consumer goods sector (agriculture and light industry).
- It is possible to expand production on a sustained basis through political mobilization. Therefore the "storming" of ambitious targets is an important way of attaining rapid economic growth.

The advocates of balanced growth take the position that unbalanced growth leads to a wasteful use of scarce resources. While they are not opposed to the development of heavy industry, they take the view that, because sectors in the economy are interrelated, stressing heavy industry alone is not necessarily the most effective way to achieve either rapid growth or a large capital goods sector. More specifically, they would argue that a "minimum" amount of investment must be allocated to the consumer goods sector to provide the necessary incentive and stability without which sustained economic growth is not possible.

Economic management refers both to the planning and regulation of the economy at the macro-level and to enterprise management at the micro-level. The debate over economic management centres on two related issues:

- the extent to which market mechanisms or economic levers (e.g. prices, taxes and subsidies) should be used to regulate a socialist economy, and
- the degree of autonomy that should be granted to the individual enterprise.

On the one side are those who favour the use of directive or administrative methods to plan and manage the economy. In this system, the responsibility of enterprises is to follow orders and therefore, they do not need, indeed should not have, much autonomy. On the other side are those who favour a greater reliance on market mechanisms to regulate the economy and those who would like to see enterprises permitted a greater degree of autonomy. Some who support this view do so because they believe that directive planning needs to be supplemented by market regulation because socialism is not as yet fully developed in China. Others support this view because they believe that the type of socialist economy that should be created in China is market socialism.

For most of the period between 1966 and 1976 the political faction that was in ascendancy in China generally favoured continued struggle to build socialism, unbalanced growth and directive planning. Thus the economic policy pursued in this period stressed the closing of gaps and differences (between peasants and workers, cities and the countryside, and manual and mental labour), the use of political exhortation instead of economic incentives to motivate the population, the "glorification" of capital construction, and economic management by directive planning (done partly at the central level and partly at the local level). A key slogan of this economic strategy was "self-reliance" (zili gengsheng). Since the "open door" policy is now interpreted by some as a reversal of self-reliance, it may be useful to review briefly the convoluted history of this expression.

The phrase itself gained currency during the difficult days of the 1930s and the 1940s when the Chinese Communist Party had no choice, but to make do with the limited resources and backward technology of the guerrilla base areas. Thus the expression zili gengsheng, viewed in its historical context, carries a connotation of economic self-sufficiency, even though the literal meaning of the phrase is less extreme. In the 1960s and 1970s, the phrase acquired two different interpretations. When used at the local level, self-reliance meant that localities should strive for self-sufficiency. In effect, it was a policy that encouraged the dispersion of industrial activities in the countryside and stressed the maximum mobilization of local resources for development (so that rural China would not compete with heavy industry for scarce resources). When used at the national level, self-reliance meant that the country must depend mainly on its own resources in economic development and not become too dependent on foreign trade and technology.

The current interpretation of recent history is that the Gang of Four romanticized the experience of the guerrilla war period and therefore, distorted the concept of zili gengsheng to justify a policy of economic isolation. In fairness to the historical record, however, it must be said that the published versions of the ultra-left point of view do not entirely support this interpretation. Indeed, both the earlier writings of Mao and the later writings of Mao's ultra-left allies seem to reject a policy of economic isolationism.[3] However, the gap between words and actions can be a wide one. What the ultra-left leaders stood for in theory and what they created in practice may have been two very different things. The chaos and xenophobia of the Cultural Revolution were hardly conducive to international economic co-operation. After all, if a lifelong Communist with the prestige and status of a Liu Shaoqi or a Deng Xiaoping could be attacked for toadying to the capitalists, what sensible middle-level official would show any enthusiasm for business dealings with the West? Seen from this perspective, the current view that the ultra-left policy was essentially a closed door policy becomes more plausible.

After the purge of the Gang of Four, who had strongly supported continued socialist revolution, Chinese policy shifted from one that stressed the building of socialism to one that emphasized economic construction. At every opportunity, Chinese leaders referred to the new national objective of modernizing agriculture, industry, defense, and science and technology (the four modernizations) by the year 2000. The core of the four modernizations was the Ten-Year Plan (1976-1985) approved by the Fifth National People's Congress (NPC) at its first session in early 1978. In his report to the Fifth NPC, Hua Guofeng revealed some of the plan's objectives.[4] It called for total agricultural output to rise at an annual rate of 4 per cent to 5 per cent and for industrial production to rise annually by about 10 per cent, both significantly higher than past performance. To achieve these ambitious goals, huge investment programs were announced--in total, the capital funds budgeted for 1978-1985 were to equal the total for the previous 28 years. Significantly, China also announced that it would turn to the Western developed economies for advanced technology and assistance to achieve its modernization objectives. Self-reliance was still held up as one of China's cherished principles, but international economic co-operation and the use of foreign funds were now seen as important means towards the achievement of self-reliance. Thus the Ten-Year Plan signalled on the one hand, a continuation of the unbalanced growth strategy and on the other hand, strongly repudiated the relatively isolationist policy of the previous ten years. But, as it turned out, the days of unbalanced growth were also numbered.

At the famous Third Plenum in December 1978, 11 months after Hua's report to the Fifth NPC, the Ten-Year Plan was discarded and with it the unbalanced growth strategy. A new long-term plan was not introduced to replace the Ten-Year Plan. Instead, the government announced that while the four modernizations are still China's ultimate goal and that while it still adheres to the "open door" policy, the economy would temporarily be "put on hold" to undergo a program of "readjustment, restructuring, consolidation, and improvement" (hereafter readjustment and reform). The new policy not only signalled the beginning of a new development strategy for China, but it also had important implications for the conduct of the "open door" policy--as Western businessmen soon discovered when contracts they had signed with various Chinese foreign trade corporations at the end of 1978 and the beginning of 1979 were suddenly postponed or cancelled. It is therefore useful to examine why the Chinese feel readjustment and reform are necessary.

According to the Chinese, readjustment is needed to correct the serious imbalances that exist in the economy, the legacy of past unbalanced growth. A detailed and authoritative analysis of the problems can be found in the report that Premier Zhao Ziyang presented to the Fourth Session of the Fifth NPC in late 1981 in which he spoke of the principles of economic development in terms of ten guidelines.[5] The fundamental premise of Zhao's report, and of many other recent Chinese statements on the subject, is that the "extensive" (waiyan) growth strategy of earlier years is no longer adequate and must now be supplemented or even replaced by "intensive" (neihan) growth. In other words, although quantitative change (simply producing more machines and building more factories) may be a reasonably effective growth strategy during the early stages of industrialization, qualitative change (technological innovation, better management and so on) is essential to sustained economic growth at a more sophisticated stage of development. Closely related to the view that brute capital formation is not an efficient engine of growth is the idea that, in the past, China has tended to overemphasize investment at the expense of consumption, with severely harmful consequences for morale and motivation. A parallel criticism is that, in the past, China has allocated too much investment to heavy industry and productive capital (plant and equipment) and too little to light industry and unproductive capital (housing and infrastructure). And within heavy industry, investment has also been unbalanced, with insufficient funds allocated to the energy sector. The intense struggles that accompanied these readjustments came into the open at the 12th Party Congress in September 1982, when the 1978 slogan "organize a new Great Leap Forward" was denounced and "the principal leading comrade in the Central Committee at the time" (Hua Guofeng) was criticized for continuing to make "Left" mistakes.[6]

To correct these imbalances and return the economy to a balanced growth path, the government in 1979 began to curb and tighten its control over capital construction, emphasize the urgency for energy conservation and exploration and for the development of transportation, reallocate resources from the capital goods sector to the consumer goods sector, improve the economic environment facing the Chinese farmers and workers, and increase the effort to upgrade existing industrial enterprises. In November 1982, the long-awaited 6th Five Year Plan (1981-1985) was announced, and it reaffirmed the leadership's commitment to readjustment, reform and the balanced development of the economy. In his report on the 6th Five-Year Plan, Zhao Ziyang revealed that the planned level of capital construction for 1981-1985 will be about the same as for the previous five years, but that far fewer large/medium projects will be undertaken.[7] Energy and transportation, the two high priority sectors, will receive 38.5 per cent of the total investment in capital construction during 1981-1985. Total fixed investment planned for the five years will amount to RMB 360 billion, of which 38 per cent is earmarked for improving existing enterprises. Most importantly, the 6th Five-Year Plan commits the government to increase per capita consumption by 4.1 per cent per annum, substantially higher than what was achieved in the previous 28 years.

The current development strategy is to avoid "Great Leaps". Instead, the stress is on slower, but steadier growth with particular emphasis on getting "better economic results" (i.e. more efficient use of energy and raw materials and greater variety and better quality of output). Greater attention is to be paid to consumption in the belief that an improvement in the material quality of life will significantly increase production through its positive effect on productivity. Clearly, those who favour a balanced growth strategy are at present in firm control of economic policy.

Now that the imbalances in the economy are being corrected, the leadership's attention is turning to the issue of reform--i.e., how best to restructure China's economic system so as to improve productivity and economic efficiency. Judging by what they have said about reform, the Chinese are primarily concerned about correcting the following practices: the tendency towards "absolute egalitarianism"; the lack of enterprise autonomy; and the over-dependence on directive planning.

The two aspects of "absolute egalitarianism" that concern the Chinese are the practice of "eating from the big pot" and the "iron rice bowl". At issue is the incentive system for individuals and enterprises that developed in China during the 1960s and the 1970s. "Eating from the big pot" describes the practice whereby workers who work hard and get good results are paid the same as those who work less hard and achieve inferior results. It also refers to the fact that, since enterprises receive everything from the state and return everything to the state, there is no incentive for enterprises to lower costs or to improve management. The "iron rice bowl" refers to the practice of permanent employment in industrial enterprises and the practice whereby cadres may be promoted, but never demoted. These practices are now criticized because they "dampen labour enthusiasm", encourage lax discipline and indolence among workers, perpetuate incompetence in the bureaucracy, and are contrary to the socialist distribution principle of "to each according to his labour".

At present, the official assessment of China's economic management system is that decision-making power is "over concentrated" and that the system has failed "to separate the functions of the government from those of the enterprises in matters of management."[8] Hence the current interest in finding ways to reduce the dependence on directive planning and to increase enterprise autonomy. To give enterprises greater economic incentives and to make them financially more responsible are, of course, closely related to the government's desire to uproot the practice of "eating from the big pot". Enterprises have also been granted limited autonomy to: produce outside the plan (once the plan quota has been fulfiled); market products not taken up by the state marketing agencies; retain a percentage of after-tax profits and use these retained earnings according to the stipulated guidelines for workers' welfare, workers' bonuses, or enterprise development; develop their own bonus schemes; and discipline or even dismiss unsatisfactory employees. A parallel reform is to allocate new investment funds as interest-bearing bank loans rather than as free grants from the state budget. Yet another aspect of the reforms is that enterprises, which because of small-scale or backward technology are hopelessly uneconomic, are now being pressured to "close down, suspend, merge, or shift to other work" (guan, ting, bing, zhuan)--that is, to face the catharsis of receivership and bankruptcy.

The government has accepted the view that, to properly manage the economy, both directive planning and market regulation through economic levers (e.g., prices, taxes and subsidies) are needed. It has spoken about dividing enterprises into several categories. Key enterprises and those that produce commodities vital to the economy will be subjected to mandatory planning and, presumably, they will operate much like they do today. Enterprises that produce a diversity of products, or products less important to the economy, will be subjected to guidance planning under which, presumably, they will have decision-making power over such matters as product-mix and will be partly regulated by market forces. Finally, small enterprises will organize their production totally on the basis of market conditions. But the government has moved cautiously in introducing the necessary reforms. Indeed, government efforts in the past few years have concentrated more on rebuilding the planning system and on tightening the central control that eroded during the 1960s and the early 1970s than on reforming the existing economic management system. The current official view is that the three years that remain in the current five-year plan should be used to draw up an overall plan to reform the economic system and to work out concrete measures for its implementation, and that comprehensive reform of the economic system will take place gradually during the 7th Five Year Plan period (1986-1990).[9] Specifically, the long overdue price reform, without which many of the other needed reforms cannot be effectively implemented, has been postponed until at least 1986.

The Lessons of the Four Waves

In addition to the new development strategy, the other factor that has influenced the "open door" policy is China's past experience in technology transfer. A lively discussion on the importance of technology transfer to economic development has accompanied the adoption of the "open door". The most interesting aspect of this discussion has been the commentaries on China's own experience with borrowing technology from abroad since 1949--an experience commonly described in terms of four waves or cycles.

The first wave of technology transfer occurred in the 1950s when 156 complete plant projects from the Soviet Union and a similar number of turnkey projects from East European sources provided the technological core of China's First Five Year Plan. One Western analyst has called this "the most comprehensive technology transfer in modern industrial history."[10] During our discussions in Beijing, a senior researcher at the Chinese Academy of Social Sciences (CASS) offered an equally positive assessment of this first wave, emphasizing that the Soviet input had involved much more than the supply of turnkey plants. She told us that 50 per cent to 70 per cent of the Soviet equipment came with full blueprints and specifications, thereby making it relatively easy to do repairs, to produce spare parts, and even to duplicate the equipment for other factories. Furthermore, from the beginning the Chinese machine-building industry was encouraged, with the help of Russian documentation and advisers, to produce some of the machinery for the 156 plants domestically, thereby facilitating learning-by-doing and creating an indigenous technological capability. It came as a great shock when, in 1960, the Soviet Union "tore up contracts, withdrew its experts, and discontinued the supply of equipment".

With Russian supplies of machines and equipment cut off, China turned to alternative sources. Negotiations with Japan for the construction of two synthetic textile factories, begun in September 1962, marked the start of China's second wave of technology import. From small beginnings, this wave grew rapidly for about three years during which China purchased a variety of complete industrial plants (variously reported as 46, "50 or more", or "over 80" in number) from Japan and Western Europe.[11] But the outbreak of the Cultural Revolution halted the second wave before it had developed very far. Foreign businessmen and technicians were harassed by the Red Guards and the absorption of foreign technology was severely disrupted. For example, the imported truck factory at Wuhan, begun in 1964, did not manage to produce its first vehicle until 1977.

The third wave of plant and machinery imports developed in the early 1970s as the disruption and xenophobia of the Cultural Revolution were receding. In 1973, the State Council approved a plan to spend US $4.3 billion on imported equipment over a four-year period. Taking its name from the planned level of expenditure, this third wave of imports came to be known as the "Four Three Programme". Criticisms of the third wave have focused on three problem areas.[12] First, projects in the program were unable to meet construction schedules. Apparently, of the complete plants built under the "Four-Three Programme", not a single one was debugged and brought on-stream according to the deadline specified in the contract. Second, due to inadequate planning, most completed projects in the late 1970s were operating at less than full capacity. And third, nearly all the projects in the "Four-Three Programme" exhibited poor returns on investment.

These criticisms have not gone unnoticed or unchallenged, but the critics and the defenders of the "Four Three Programme" agree that China's third wave of technology transfer had problems and shortcomings. However, says Chen Huiqin: "Not only did we not earnestly study the lessons of this period, but we immediately launched another big wave. Within the single year of 1978, foreign contracts worth US $6.4 billion were signed."[13] In the eyes of the critics, this unprecedented surge of technology imports was a classic case of "more haste, less speed". In an article published in Jingji Guanli (Economic Management) in 1981, Lin Senmu, one of these critics, suggested that there are four lessons to be learned from the mistakes of 1978.[14] First, if a factory is to be imported, careful provision must be made for the complementary domestic inputs--fuel, utilities, transport, housing, etc. As an example, Lin points out that the 22 key projects in the fourth wave, once completed, would require over 10 million tonnes of petroleum and 20 million tonnes of coal annually, "which is simply unmanageable in our country's present energy situation." Second, it is important to be sure that a project encourages self-reliance. (Lin judges self-reliance by asking two questions: Does the project use domestic components whenever possible? And is it free from the "push-button mentality, that is, does it avoid excessive automation?) Third, no project should be approved until its technical and economic feasibility has been carefully checked for, as Lin says, "Blind enthusiasm leads to fatal economic illnesses." And fourth, China must become much better informed about the ways of the Western business world. Quoting Lenin, Lin argues, "When one runs with wolves, one must learn to howl like a wolf."

When the discussion of the fourth wave gets down to cases, the critics most often zero in on the giant Baoshan General Iron and Steel Works near Shanghai. The Baoshan project, for which construction began in December 1978, has the distinction of being both the largest and most controversial plant that China has ever imported. However, it is not clear when, if ever, Baoshan will reach its original planned annual output levels of about 6 million tonnes of pig iron, 6.1 million tonnes of rolled steel, and 500,000 tonnes of seamless steel tube.[15] In the rush to get Baoshan started, decisions were made and contracts were signed before feasibility studies were even done. The site chosen turned out to be too swampy to support heavy industrial installations, and tens of thousands of piles had to be driven into the spongy ground before stable foundations could be poured. Because domestic iron ore is unsuitable for the Baoshan equipment and the Yangzi River is too shallow for bulk carriers, an expensive new port had to be built at Beilun to handle ore imports from Australia. When an investigative group from the State Council visited Shanghai in 1980, it noted that China's largest city was already suffering from serious bottlenecks in transportation and communications and from shortages of fuel and electricity, and concluded that the Baoshan project could only exacerbate an already difficult situation.[16] Writing in People's Daily in March 1980, an official of the Ministry of Metallurgy criticized Baoshan for its excessive automation and its environmental pollution, among other problems.

This list of Baoshan criticisms is a lengthy one, but the most fundamental problem of all has not yet been mentioned. Even if construction were on schedule, even if supplies of all inputs were assured, even if domestic equipment were used whenever possible and so on, the basic question would still remain: Why build Baoshan at all? Aren't there other projects, especially in light industry, that are more urgent and have higher rates of return?

When we posed this question at Baoshan, the senior engineer who was our guide gave us a two-part answer. First, he said, Baoshan will have lower unit costs than can be achieved with older, smaller-scale factories. (From his discussion, it was clear that he had a partial definition of unit costs in mind--fewer units of raw materials, especially coal, used per tonne of steel produced. Whether total costs per tonne, including capital costs, would be lower at Baoshan remained a moot point). Second, he continued, China produces only about 35 million tonnes of steel per year and more is needed for modernization. When asked about the rate of return on the Baoshan investment, he replied that the payback period would be "between one and two decades" (shiji nian). But, we persisted, isn't this a rather low rate of return compared to other sectors? "China is a socialist country," he replied, "and we must have both light and heavy industry." The critics have been quick to challenge such an argument. As an editorial in People's Daily in February 1979 put the issue:

> A big country like ours naturally needs more steel, and the slogan of 'taking steel as the key link' reflects this need. But the slogan of 'taking steel as the key link' is certainly not an objective law, immutable for all time. . . . To increase the output of steel inevitably means that investment in agriculture and light industry must be reduced. But agriculture and light industry exhibit quick returns on modest investment, and they are essential to the people's livelihood.[17]

These discussions of the lessons to be learned from China's four waves of technology import are strikingly different in quality from the sterile policy debates of a few years ago. Fervent reiteration of the slogan zili gengsheng was never a satisfactory substitute for careful analysis of complex policy choices. Accusations of "groveling behind the foreigners' buttocks" were equally unconstructive. But the tone now is much different. China's scientists and technicians are insisting very vocally that economic policy questions cannot be answered adequately without careful investigation, scientific evidence and "the collective wisdom of experts".[18]

Key Elements of the "Open Door" Policy

Superficially, the phrase "open door" might appear to mean simply trade liberalization, but this is a misinterpretation. True, China's foreign trade has grown to unprecedented levels since the Third Plenum in 1978, even after some mental adjustment is made to the doubling of trade value between 1978 and 1981 to correct for price inflation. However, this increase in trade does not mean that the "open door" is just a synonym for free trade in the conventional textbook sense of that term. China is not about to permit an unfettered flow of commodities, much less of capital, across its borders. This is evident from the frequency with which "open door" advocates insist that "we should not import things which can be made at home"[19]--an argument that, interpreted literally, could almost eliminate trade altogether. Indeed the indiscriminate import of foreign goods, in the view of the Chinese leadership, may impair the development of China's national economy and thus diminishes its ability to become self-reliant.[20]

Thus, the logic of the "open door" is not the logic of trade liberalization, although some of the consequences are the same. Rather, the essence of the "open door" is to be found in the Third Plenum's call to "strive to adopt the world's advanced technologies and equipment". As Deng Xiaoping and Zhao Ziyang have both stressed, the door is being opened because the four modernizations require it. Perhaps a more accurate description of the "open door" is that it is an outward-looking policy that stresses not only increased technological exchanges with other countries, but also the speedy "entry of Chinese products into the world market" and the vigorous expansion of certain types of foreign trade. In supporting this view of the "open door", Zhao Ziyang argues that:

> Expansion of exchange is a basic feature of large-scale socialized production, and it has extended from internal trade in China to trade with the world at large. By linking our country with the world market, expanding foreign trade, importing advanced technology, utilizing foreign capital and entering into different forms of international economic and technological co-operation, we can use our strong points to make up for our weak points.[21]

In the area of technology transfer, the "open door" is not just a replay of the four earlier waves, but involves some significant qualitative changes in China's attitude towards technology transfer. For example, the new attitude is evident in China's willingness, as indicated by the 1979 Law on Joint Ventures, to facilitate technology transfer by accepting long-term capitalist participation in some projects, and even to grant the foreigners day-to-day managerial authority.

The change from an extensive to an intensive growth strategy and the previous difficulties in absorbing advanced technology have influenced the Chinese to give technology a broader interpretation that encompasses management and marketing skills and know-how, rather than just engineering in a narrow sense.[22] The economists at CASS would have no trouble agreeing with the General Motors executive who suggested that:

> the secret of industrial development and of technology assimilation is not in the import of expensive turnkey plants from abroad, but in the orchestration of the myriad details into a harmonious whole. . .[T]here are good reasons why countries are willing to pay hundreds of millions of dollars to Western manufacturers to come in and license them. These manufacturers are not licensing the design; they are licensing the *system* and the *processing*. What they need is not the prototype to copy but the drawings with the material specifications and the tolerances, the routing sheets, and the basic understanding and expertise to orchestrate everything so that all the millions of things can come together to make a truck.[23]

It is now clear that the Chinese are interested in acquiring not only technology that is embodied in machinery and equipment and which is codified (i.e., documented in blueprints, drawings and engineering specifications), but also disembodied and undocumented technology (i.e., information, skills and know-how stored in the minds of individuals).

Because of the current emphasis on improving the productivity of existing enterprises and the increased awareness of the importance of assimilating and absorbing new technology, China is now more careful about what technology it imports as well as what mechanism is used to transfer the technology. In particular, the Chinese are anxious for foreign participation in the technical transformation of China's older enterprises. This will undoubtedly involve the import of some new equipment, but more important it will involve engineering and management assistance. Because of these concerns, Chinese leaders have said repeatedly that:

> From now on, China should mainly import technology and single machines or key equipment which cannot be produced domestically. We should not import complete sets of equipment every time and must avoid duplicating imports. We should not import equipment without know-how or fail to assimilate the imported technology and to popularize what we have learnt from it.[24]

Another reason why the "open door" is closely linked to the intensive growth strategy, apart from the concern for effective assimilation of technology and the interest in means of transferring technology other than the purchase of complete sets of equipment, arises from the recognition that a policy of squeezing consumption too hard is actually inimical to economic growth, because it undermines morale and motivation. As Mao Zedong himself said at an earlier date, it is foolish to drain the pond to catch the fish--hence the recent reduction of the share of accumulation in national income to below 30 per cent. But of course the increase in consumption's share reduces both the resources available for domestic capital formation and the resources available for export to pay for imported investment goods, thereby exacerbating both the savings constraint and the balance of payments constraint on growth. This squeeze on investment certainly helps to explain the recent intense interest in the methodological issues surrounding the evaluation of economic effectiveness, as exemplified in Li Qiang's remark that China must distinguish between "what is in urgent need and what can wait".

The reality of scarcity and the squeeze on investment also explain China's unprecedented willingness to welcome long-term foreign financing, both equity and debt, from capitalist sources. In 1974, Li Qiang insisted that China did not intend to utilize foreign capital or engage in joint ventures. In 1979, he argued:

> [F]rom a Marxist-Leninist point of view, the methods we are adopting for utilizing foreign capital in joint ventures to develop China's resources are correct in principle. . . . We are paying for some major imported items with deferred payments, bank credits or loans. These are beneficial to expediting the four modernizations and solving the problem of payments within a specified period of time.[25]

The current policy towards foreign capital is as follows:

> [T]o speed up our economic construction, it is definitely necessary to utilize as much foreign capital as possible. . . . the amount of foreign capital we can utilize is not determined by our subjective desires, but by what we can do at home, that is, mainly by our ability to repay, to provide the necessary accessories and to assimilate advanced technology.[26]

To dilute the rigidity of debt with an admixture of equity, China is utilizing such innovations as joint ventures and the joint development of energy resources on a compensation trade basis. These projects are all, in one fashion or another, profit-sharing in nature and therefore will not be saddled with inflexible foreign payments if they fall on hard times. Furthermore, the Chinese have explicitly imposed the requirement that these ventures must have adequate export potential to cover their own foreign-exchange needs.[27] Because these equity arrangements shift more of the risk onto the foreign participants, they are likely to be acceptable to the foreigners only if they are allowed a substantial voice in management. Since, from the point of view of encouraging an effective transfer of technology, this kind of long-term foreign participation is an advantage, not a disadvantage, equity financing is doubly attractive to the advocates of the "open door".

To help finance the import of technology and the other foreign-exchange requirements of the Four Modernizations, China is now boosting its exports more aggressively than ever before. Most significantly, it has softened its past stance against the "selling of natural resources" and is now willing to expand its exports of oil, coal and some rare metals in a planned way. Indeed, China now welcomes "foreign investment in developing its energy resources", specifically its coal and offshore oil deposits. The fact that slow growth in energy supply is the most serious constraint on China's economic growth undoubtedly also contributes to a willingness to accept foreign participation in the development of its energy resources, and to pay for the foreign contributions with future energy output. The promotion of exports is also related to the intensive growth strategy. As Zhao Ziyang explains: "Putting China's products to the test of competition in the world market will spur us to improve management, increase variety, raise quality, lower production costs and achieve better economic results."[28]

Another important aspect of the "open door" is that a special role and considerable autonomy have been given to the coastal regions. Zhao Ziyang, speaking for the leadership, emphasizes that: "to expand economic and technological exchanges with foreign countries, we must make full use of the coastal areas, and especially the coastal cities."[29]

The special emphasis on the coast is understandable since the urban coastal areas are among China's most developed regions and therefore, have greater capacity to absorb foreign technology and investment. The coastal cities have had a rich history of interaction with foreign countries. In addition, some of them have strong ties with overseas Chinese communities, a source of capital and expertise that China is now anxious to tap. Furthermore, China may be hoping that the development of economic linkages between its coastal regions and the overseas Chinese communities will smooth the way to the eventual return of Hong Kong, Macao and Taiwan to Chinese administration.

The regional approach is also related to the policy of readjustment and intensive growth. As already noted, one of the key features of readjustment has been the shift of emphasis away from heavy industry toward agriculture and light industry, and from investing in new construction to the upgrading of existing enterprises. Unlike the megaprojects that typify heavy industry, many projects in light industry and the renovation of existing plants are small in scale and lend themselves well to decentralized control. Projects under local control also adjust more effectively to local conditions, appeal to the regional identities and loyalties of overseas Chinese communities, and so on. Because much of China's light industry and many of its older enterprises are concentrated in its urban coastal areas, readjustment and intensive growth reinforce the regional orientation of the "open door".

In summary, it might be said that at present the "open door" has five key features. Three of these--the concern for an effective transfer of technology, the desire to expand exports and the willingness to utilize foreign financing--are essential elements of the "open door" itself and therefore, by definition, will endure as long as the door remains open. The other two--the special attention to the energy sector and the regional orientation--are not so essential to the meaning of the "open door" perhaps, but serve important purposes in their own right and are therefore unlikely to disappear while the door is open.

The "Open Door" in Practice

What changes have resulted from the "open door" policy? Space precludes an in-depth examination of the experience of the past four years.[30] What follows is, but a summary of what the policy has achieved to date.

Institutional changes aimed at improving the interface between foreign technology and investment and the Chinese domestic economy have been introduced. Most obvious is China's acceptance of new mechanisms for foreign economic relations and trade, particularly new ways to use foreign capital and to transfer technology.[31] Prior to

1977, China's commercial relations with non-socialist countries were largely limited to arm's-length trade. Foreign technology was acquired primarily through the import of machinery and complete plants. Credits were used only sparingly. The approach now is significantly more flexible. In marketing its exports, China is more sensitive to the needs and demands of foreign buyers. Increasingly, licensing arrangements are used to acquire technology. But the most important development is the Chinese use of "special trade" arrangements (to distinguish them from "normal" or arm's-length trade) to acquire technology, utilize foreign funds and expand exports. Because special trade arrangements are usually financed in part by the foreign participants, the Chinese also refer to the foreign funds involved in these arrangements as "foreign investment".

The Chinese classify special trade arrangements into the following five categories:

- lai-liao jia-gong/lai-jian zhuang-bei, the processing/assembling of raw material/components supplied by foreign participants;
- bu-chang mao-yi, compensation trade arrangements under which foreign participants supply China with machinery and receive products, usually produced by the same machinery, in compensation;
- he-zi jing-ying, equity joint ventures established according to the Chinese Law on Joint Ventures;
- he-zuo jing-ying, co-operative ventures involving Chinese and foreign parties where the arrangement is not strictly according to the Law on Joint Ventures; and
- he-zuo kai-fa, the joint development of China's natural resources.

This is not the place to examine these arrangements in detail. We shall limit ourselves to three brief observations. First, the only special trade arrangement that involves foreign investment, as the term is generally understood outside China, is the equity joint venture. Second, the special trade arrangements presented above are often discussed as if they always exist in their "pure" forms. In practice, they tend to shade into one another, taking features from several arrangements so that it is often difficult to say unequivocally that an arrangement is of a specific type. And third, the special trade arrangements are not only ways by which China may utilize foreign funds, but to varying degrees, they are also effective channels for the transfer of technology (including marketing and managerial know-how) from the foreign participant to the Chinese enterprise. That China is now willing to use a wide variety of special trade arrangements is confirmation that it, too, recognizes that many transfer mechanisms are needed if it is to successfully acquire a wide range of technology from abroad.

In its first three years, the "open door" attracted only a limited amount of foreign technology and capital. Table 1 presents the available data on "foreign investment" and special trade arrangements in China. From 1979 to the end of 1981, China approved "foreign investment" amounting to slightly more than US $3 billion. This figure refers to the cash and the value of equipment and technology pledged by foreign firms involved in economic co-operation projects in China. Actual arrival was considerably less. If the ratio of "investment" pledged during 1979-1981 at the national level was no better than that reported in Guangdong (.212),[32] then the actual amount of "foreign investment" that arrived may be as low as US $636 million. A variety of special trade arrangements was used to absorb foreign technology and capital. At one extreme are the large, long-term offshore oil exploration projects, and at the other extreme are the numerous one-shot processing arrangements that are more important for the foreign exchange they generate than for the equipment and know-how they transfer.

The equity joint venture, because of its greater legal complexity and economic involvement, has developed relatively slowly. Twenty joint ventures were approved in 1980 and another 20 received approval in 1981, bringing the cumulative total to 40. At the end of 1981, 27 of the 40 were reported to be in operation. The total investment in these 40 joint ventures amounts to US $189 million, of which foreign investment amounts to US $87.5 million. From press reports, we know that joint ventures range in size from very small enterprises such as the Yanhua Standard Battery Company (capital: US $130,000) to fairly large hotel development projects such as the Jianguo Hotel (estimated cost: US $20 million). However, most are small- and medium-sized enterprises. Of the 40 joint ventures, 13 have registered capital of less than US $500,000 and only five have registered capital in excess of US $10 million.[33] Twenty-seven of the 40 joint ventures are in manufacturing, three in agriculture and ten in services (mostly tourism). Half of the 40 joint ventures involve Hong Kong firms and eight involve US firms. In terms of the amount of foreign investment absorbed and the sophistication of technology and managerial know-how transferred, one suspects that the Chinese must be a little disappointed by what has been achieved through the joint-venture mechanism to date.

To judge by developments to the end of 1981, it appears that the flexibility of alternative special trade arrangements has made them more attractive than the joint venture with its relatively rigid set of regulations. In terms of numbers of contracts signed, simple processing and assembling agreements dominated the scene (about 95 per cent of all contracts signed). The rapid development of processing arrangements is to be expected since it is a relatively straightforward commercial contract that has been in use internationally for some time. However, the processing agreements have often been very small in scale (providing on average only about US $8,200 worth of equipment to the Chinese partner).[34] By contrast, the average compensation trade deal during 1979-1981 involved foreign equipment worth about US $780,000 which explains why the few hundred compensation trade deals signed have provided three times as much equipment as all the thousands of processing and assembling agreements combined. Measured by the amount of capital pledged, co-operative ventures have been more important than either processing agreements or compensation trade, constituting barely 2 per cent of the contracts signed and yet accounting for about 60 per cent of the investment pledged. As was to be expected, the joint development of natural resources, because of the risk, the greater technical complexity and the large initial investment required, has also developed slowly. The 13 agreements noted in Table 1 include nine for seismographic studies and four exploration contracts. Although offshore oil development has proceeded more slowly than originally expected, the exploration contract with British Petroleum and its partners (including Ranger Oil and Petro-Canada) that was signed in May 1983 appears to signal the beginning of a major new wave of energy investment.

In geographic terms, the province of Guangdong has attracted most of the "open door" activities to date. About 58 per cent of all processing fees earned in 1980-1981 were earned by Guangdong enterprises; one-third of the equipment pledged to China as part of compensation trade agreements is destined for Guangdong, and 83 per cent of all foreign funds pledged to co-operative ventures are also for Guangdong.[35] After Guangdong, Shanghai has been the next most active, earning 13 per cent of the processing fees paid to China during 1980-1981 and accounting for 11 per cent of the equipment pledged as part of compensation trade agreements.[36] Joint ventures are less concentrated in Guangdong; most are located along the coast. Of the 33 joint ventures (out of the 40 in existence at the end of 1981) whose location we were able to ascertain, 28 were in Beijing, Shanghai, Tianjin, Guangdong or Fujian.

Development to date suggests that even though qualitatively the "open door" has significantly altered China's approach to technology transfer and the utilization of foreign capital, the quantitative impact has been relatively modest. The unsteady development of special trade arrangements and the continued reluctance of the Chinese to finance their technology import by borrowing aggressively can be attributed in part to the following factors. First, China had the misfortune to begin pursuing its "open door" strategy just when the Western economies entered their deepest recession since the Great Depression. This unhealthy economic environment has made it more difficult for China to export its products. Indeed, the rising tide of protectionism in major world markets now poses a serious problem for the "open door" strategy. Second, high interest rates have greatly increased the cost of borrowing. This has made the Chinese very cautious about incurring external debts, recognizing as they do that a large debt, if not managed judiciously, can lead to the kinds of repayment problems that now confront Poland and Mexico. Third, with readjustment and reform, China took time to sort out its priorities. For the past several years, China has operated without a long-term plan to guide its decision-makers. This lack of direction has undoubtedly slowed negotiations of international economic co-operation projects. Fourth, the significant differences between the Chinese and the Western legal and economic systems increase the transaction costs of doing business with China as well as the perceived risk of such arrangements. Of course, high transaction costs and risk are features that tend to discourage the rapid development of economic relations between China and the West.

These factors are beginning to change. Economic recovery in the West has begun; nominal interest rates have fallen and real interest rates are beginning to decline; a legal framework to govern China's economic relations with foreign firms is emerging; and, since November 1982, China has had a five-year plan. The real test of whether China will attract, assimilate and absorb a significant amount of foreign technology and capital is about to begin.

Notes

1. For the text of the communique of the Third Plenum, see Beijing Review 29 December 1978, pp. 6-16.
2. Marxian economics identifies productive forces and production relations as the two main aspects of social production. Productive forces are the inputs (men, materials, and equipment) to production, and production relations are the relations formed by people during the production process--specifically they are property relations, the roles and relations among people in production, and the pattern of product distribution.
3. See, for example, Mao Zedong, "On the Ten Major Relationships", Beijing Review 1 January 1977, pp. 23-25 and Gao Lu and Chang Ge, "Ping Deng Xiaoping de maiban zichan

jieji jingji sixiang" (A critique of Deng Xiaoping's comprador-bourgeois economic thought), Hong Qi 1 July 1976, pp. 25-30.

4. Hua Guofeng, "Report on the Work of the Government", delivered at the Fifth National People's Congress, 26 February 1978.

5. The full text was published in Renmin Ribao, 14 December 1981, pp. 1-4. For an English translation, see Beijing Review 21 December 1981, pp. 6-36, "The Present Economic Situation and the Principles for Future Economic Construction": Zhao Ziyang's report on the work of the government to the Fouth Session of the Fifth NPC, 30 November and 1 December 1981.

6. Beijing Review 13 September 1982, and 8 November 1982, p. 18.

7. These and the following figures are from Zhao Ziyang, "Report on the Sixth Five Year Plan", delivered at the Fifth Session of the Fifth NPC on 30 November 1982. For a slightly abridged English translation of the speech, see Beijing Review 20 December 1982, pp. 10-35.

8. From "The Present Economic Situation", Zhao Ziyang's report, p. 25.

9. Zhao Ziyang, "Report on the Sixth Five Year Plan," Beijing Review 20 December 1982, p. 30.

10. Hans Heymann, Jr., quoted in A. Doak Barnett, China's Economy in Global Perspective (Washington, D.C.: Brookings Institute, 1981).

11. Robert F. Dernberger, "Economic Development and Modernization in Contemporary China: The Attempt to Limit Dependence on the Transfer of Modern Industrial Technology from Abroad and To Control Its Corruption of the Maoist Social Revolution" in Issues in East-West Commercial Relations, A compendium of papers submitted to the Joint Economic Committee of the US Congress, pp. 91-121, (Washington, D.C.: US Government Printing Office, 1979), at p. 97; Barnett, p. 193, and Gu Ming, "Plans Readjusted, Policy Unchanged", Beijing Review 27 July 1979, p. 9.

12. See, for example, Chen Huiqin, "Jishu yinjin de fanxiang bixu

zhuanbian" (The orientation of technology transfer must be changed), Jingji Guanli (Economic Management), April 1981; and Meng Xiancheng, "Some Questions on the Building of the 1.7 Meter Rolling Mill", Beijing Review 25 August 1980, p. 26.

13. Chen Huiqin, "Orientation of technology transfer", 23.

14. Lin Senmu, "Ershier ge chengtao shebei yinjin xiangmu de jiaoxun" (The lessons of the 22 imported complete plant projects), Jingji Guanli, June 1981, pp. 13-14.

15. For details of the complicated off-again, on-again history of Baoshan, see China Business Review (September-October 1979): 58-60, (July-August 1980): 47-49; (January-February 1981): 9-13; and (March-April 1982): 4; Far Eastern Economic Review, 20 February 1981, pp. 49-50 and 57; JETRO China Newsletter, (February 1981): 10-11; (March-April 1981): 2-5; and (May-June 1981): 8-13. In April 1983, it was announced that both phases of Baoshan will definitely be completed, but no specific deadline was given.

16. Beijing Review, 28 July 1980, pp. 15-18.

17. Renmin Ribao, 24 February 1979, p. 1.

18. Beijing Review, 15 June 1981, p. 3.

19. See for example, Renmin Ribao editorial of 8 May 1979, p. 1, and Hong Qi 16 April 1982, p. 6.

20. For example, Hu Yaobang, "Create a New Situation in All Fields of Socialist Modernization", Beijing Review 13 September 1982, (pp. 11-40), p. 20.

21. "The Present Economic Situation", Zhao Ziyang's report, p. 23.

22. Hong Qi, 16 April 1982, p. 6; and Shijie Jingji Daobao (World Economic Herald), 7 June 1982, p. 4.

23. Ralph Miller, quoted in China's Four Modernizations: The New Technological Revolution, edited by Richard Baum (Boulder, Colorado: Westview Press, 1980), 205.

24. "The Present Economic Situation", Zhao Ziyang's report, p. 24.

25. For 1974 quote, see US Congress, Joint Economic Committee, Chinese Economy Post-Mao, (1978, vol. I, p. 722); for 1979 quote, see "Minister Li Qiang on Expanding China's Foreign

Trade to Speed Up the Four Modernizations", Beijing Review, 27 April 1979, pp. 15-16.

26. "The Present Economic Situation", Zhao Ziyang's report, p. 24.
27. Ji Chongwei, "China's Utilization of Foreign Funds and Relevant Policies", Beijing Review 21 December 1981, p. 19.
28. "The Present Economic Situation", Zhao Ziyang's report, p. 24.
29. Ibid.
30. For a more detailed analysis of the experience to date and for case studies of special trade arrangements, see our monograph, China's "open door" Policy: The Quest for Foreign Technology and Capital, (forthcoming).
31. To accommodate the "open door", China has also modified its foreign trade system. Four general types of changes have been introduced:
    - Incentives have been introduced to encourage localities, ministries, and enterprises to look outward for economic opportunities and technical assistance.
    - Many more players, besides the foreign trade corporation under the Ministry of Foreign Economic relations and Trade, have been granted permission to negotiate foreign trade and international economic cooperation contracts.
    - The foreign trade system has been decentralized in a number of ways to make it more flexible and responsive and to bring Chinese producers and end-users into closer contact with their foreign partners.
    - The coastal regions, particularly Guangdong and Fujian, have been granted special authority and flexibility in the conduct of foreign economic relations and trade.
32. As revealed by the First Secretary of the Guangdong Communist Party in a speech he gave in April 1982, and reported in the China Business Review (September-October 1982), 24.
33. Ji Chongwei, "Joint Ventures with Chinese and Foreign Investment", Beijing Review 26 April 1982, pp. 19-22; and Guide to Investment in China (Hong Kong: Economic Information and Agency, 1982).

34. Of course size alone does not determine the importance or the sophistication of the imported technology. For example, we visited the Xiamen boatyard which has a processing agreement with Celestial Yachts. Under the agreement, the imported equipment consists of nothing more than a few electrically-powered hand tools, while the technology to be transferred involves the knowledge of how to lay up fiberglass sandwiching so as to achieve maximum hull strength. Here the critical ingredient is not the imported equipment but the skill of the foreign shipwright.

35. Shijie Jingji Daobao, 17 May 1982; China Business Review (September-October 1982); and interview notes.

36. Shijie Jingji Daobao, 10 May 1982.

Table 1: International Economic Co-operation Using Foreign Funds: Agreements Approved Since 1979

		1979[a]	1980	1981	1979-1981
A.	Processing/Assembling				
	Number of agreements	2980	7120	8900	19000
	Processing fee received (US $ million)[b]	29.6	112.2	188.2	330
	Value of equipment pledged by foreign participants (US $ million)	n.a.	n.a.	n.a.	156
B.	Compensation trade				
	Number of agreements	(1979/80) 147		173	590
	Value of equipment pledged by foreign participants (US $ million)	381		79	460
C.	Cooperative ventures				
	Number of agreements	n.a.	320	70	390
	Foreign investment pledged (US $ million)	n.a.	500	1300	1800
D.	Joint ventures in China				
	Number of agreements	0	20	20	40
	Foreign investment pledged (US $ million)	0	68	19.5	87.5
E.	Joint Oil Exploration				
	Number of agreements	9	4	0	13
	Foreign contribution pledged (US $ million)	0	498	0	498
F.	Total Foreign funds absorbed (US $ million)				
	Including processing	n.a.	n.a.	n.a.	3001.5
	Excluding processing	1312		1533.5	2845.5

Sources: Derived from data in Shijie Jingji Daobao (World Economic Herald), 17 May 1982 and 7 June 1982; China Foreign Trade, March 1980 and April 1982; Beijing Review 20 April 1981; China Business Review, September-October 1982, and field notes.

Notes

a. Except for processing, the other statistics for 1979 cover only the period from 1 July to 31 December.
b. Excludes fees deferred as repayment for equipment supplied by foreign participants.

16: THE ECONOMIC CONTRACT LAW OF THE PEOPLE'S REPUBLIC OF CHINA: A WINDOW ON CHINA'S LEGAL AND ECONOMIC WORLDS

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THE ECONOMIC CONTRACT LAW OF THE PEOPLE'S REPUBLIC OF CHINA: A WINDOW ON CHINA'S LEGAL AND ECONOMIC WORLDS

Introduction

In the preceding paper, it is stated that the Third Plenary Session of the 11th Central Committee of the Communist Party of China, held in December 1978, represented the "historic turning point" for China's open door policy. The same could also be said of China's policy towards law. Following a period of several years in which the party's policy towards law can perhaps best be summed up in the title of an article that appeared in 1967 in the People's Daily, "In Praise of 'Lawlessness' ",[1] law was to take on a mantle of renewed respectability and considerable importance. The communique of the Third Plenum put it this way:

> In order to safeguard people's democracy, it is imperative to strengthen the socialist legal system so that democracy is systematized and written into law in such a way as to ensure the stability, continuity and full authority of this democratic system and these laws; there must be laws for people to follow, these laws must be observed, their enforcement must be strict and law breakers must be dealt with. From now on legislative work should have an important place on the agenda of the National People's Congress and its Standing Committee. Procuratorial and judicial organizations must maintain their independence as is appropriate; they must faithfully abide by the laws, rules and regulations, serve the people's interests, keep to the facts, guarantee the equality of all people before the people's laws and deny anyone the privilege of being above the law.[2]

In short, what was to be sought for China was the establishment of a system of government based far more than it ever had been on "the rule of law".

One of the areas in which the Chinese have concentrated their efforts in this wholesale reform of their legal system is that of economic legislation. In fact, according to figures released in August of 1982 by Liu Fuzhi, the Chinese Minister of Justice, over 80 per cent of the approximately 300 laws and regulations enacted to that date were concerned with economic matters.[3] Over a dozen major statutes have been enacted in this area, starting with the 1979 Law on Joint Ventures using Chinese and Foreign Investment and including the Income Tax Law for Foreign Enterprises, the Personal Income Tax Law and the very recently enacted Trademark Law. During this same short period almost a hundred sets of regulations and "decrees" were promulgated or approved for promulgation by the State Council. These include regulations governing industrial and commercial enterprise registration, provisional regulations governing price control, and regulations governing the exploitation of offshore petroleum resources in co-operation with foreign enterprises. Further regulations and "decrees" have been promulgated by the governments of many of the provinces, centrally-controlled municipalities, and autonomous regions and by a number of departments under the control of the State Council. On the enforcement side, special economic divisions had, by the end of 1981, been established within the Supreme People's Court, within the higher people's courts of various provinces, centrally controlled municipalities and autonomous regions and also within 293 intermediate people's courts.[4] As well, special economic procuratorial organs have been established at various government levels to oversee the administration of the laws in this area. Furthermore, a new Centre for Research on Economic Legislation directly under the State Council, has been established. This centre provides the research necessary for the enactment of the many new laws and regulations on the agenda[5] as well as for the study of the strengths and weaknesses of those already being tested in the marketplace.

These developments within the economic sector of China's legal system, and the rapid growth in legislation in particular, are of considerable interest to the foreign business person whose company does or is contemplating doing business with the People's Republic of China. In fact, it is fair to say that much of the activity that has taken place in this area was spawned by foreign interest in or, more accurately, concern about the state of China's economic legislation. This is especially true in the case of those laws that are aimed specifically at the foreign companies wishing to do business with the Chinese, such as the Law on Joint Ventures using Chinese and Foreign Investment and the Trademark Law.

Because of the special foreign focus of this latter group of laws, Western commentary on developments within the economic sector of China's legal system has tended to focus on these, to the exclusion of those laws aimed primarily at the domestic economy. Thus, Western legal periodicals offer a number of studies, some of them in-depth, of the Law on Joint Ventures using Chinese and Foreign Investment,[6] but none have appeared as yet on the statute that forms the subject matter of this paper: the Economic Contract Law. As will be seen, however, the Economic Contract Law, in spite of its domestic thrust, is a law that foreign business persons would do well to examine.

The Economic Contract Law: Scope of Application and Purposes

The Economic Contract Law was adopted by the Fourth Session of the Fifth National People's Congress in December of 1981 and came into force on 1 July 1982. As its name indicates, it deals with an institution called the "economic contract", a term defined in article 2 to mean "an agreement between legal persons for achieving a certain economic purpose and for defining each other's rights and obligations." The distinguishing feature of an economic contract is, of course, the requirement that the contract be intended to achieve "a certain economic purpose." No definition of this term is given, but some indication as to what is meant by it is provided by the different kinds of contracts enumerated in article 8. That article provides that the Economic Contract Law applies to "contracts in purchase and sale, construction of projects, material processing, freight transportation, electricity supply, warehouse storage, property rental, money borrowing, property insurance, scientific and technical co-operation and other economic contracts." With the help of these examples it might be said that an "economic purpose" is a purpose associated with the business activities of the two contracting parties. Or, to put it another way, an economic contract might be said to be a contract that is intended to further the business interests of both parties to it. What is crucial, it seems, is that both parties to the contract must be pursuing business interests of one kind or another. Contracts of sale and purchase at the retail level would, therefore, not fall under the provisions of the Economic Contract Law. Nevertheless, given the number of entities carrying on business in China and the frequency of dealings between them, the scope of application of the statute is obviously very wide.[7]

The purposes of the Economic Contract Law are set forth in article 1, and they are both numerous and significant. They are said to be "to protect the legal rights and interests of the parties concerned in economic contracts, safeguard social and economic order, improve economic benefit, guarantee the implementation of state plans and promote the development of the socialist modernization programme." The meaning of the first of these purposes is clear enough. Its inclusion in the list probably stems from a desire on the part of the party to make it clear that economic contracts were no longer going to be treated with the casual indifference that marked their treatment during the preceding decade or more. From now on, economic contracts were going to be strictly enforced. The concern about "safeguarding social and economic order" is primarily a reference to the need to eliminate fraud and sharp practices from the world of economic contracts. Although not a primary focus of the Economic Contract Law as it is more a matter of criminal than of civil law, this concern is obviously an important one and is touched upon in this statute.[8]

It is easier to understand the latter three closely-related purposes if one appreciates the economic context in which the Economic Contract Law will operate. A detailed description of that context is, of course, beyond the scope of this paper. For present purposes it is probably sufficient to note that context incorporates the following features:

- almost all means of production are publicly owned, with some private ownership being encouraged;
- production and distribution are largely controlled by government planning, with market regulation being introduced as a subsidiary control mechanism;
- the planned sector is divided into mandatory plans (to cover capital goods and consumer goods that are considered to be "vital" to the national economy and the people's livelihood) and guiding plans (to cover goods considered to be important, but less than "vital");
- business enterprises are very much under the control of government ministries and bureaus, but they are in the process of being given a certain amount of autonomy in decision-making;
- business enterprises are by no means financially independent, but they are in the process of changing over from a system under which they handed over all of their profits to the state (and let the state absorb all of their losses) to a system under which they pay taxes to the state out of their profits and keep the remainder (and risk going under if they incur losses).

Within this context, the Economic Contract Law plays a number of different roles. It provides a framework of rules for the conduct of business activities involving products and items not covered by the plans. It provides that same framework of rules for the conduct of business activities involving products and items that are covered by the plans, but that concern matters of detail which the plans do not address:[9]

- By making it obligatory to enter into contracts consistent with the targets set by the mandatory plans, it ensures that those plans will be put into effect.
- By encouraging enterprises to enter into contracts

consistent with the targets set by the guiding plans, it facilitates the implementation of those plans.

- By making it clear that enterprises that do not live up to their contractual obligations will be liable to penalty payments and damages to be paid out of profits, the Economic Contract Law encourages greater operating efficiency and care.
- By providing added reason for both enterprises and planners to concern themselves with the accuracy of the plans, it encourages more effective and accurate planning.

In the performance of all these roles, the Economic Contract Law is expected to "improve economic benefit, guarantee the implementation of the plans and promote the development of the socialist modernization programme".

From the Chinese standpoint, it is clear that the Economic Contract Law is an extremely important statute, broad in the scope of its application and designed to serve a number of significant purposes. That alone might be reason enough for a foreign business person to examine its provisions, but there are several other reasons as well.

First, the Economic Contract Law is only one of two sources being used by the drafters of the forthcoming legislation (the other being "international practice") by which the "foreign economic contracts" (or the economic contracts between a Chinese enterprise and a foreign enterprise will be governed). This is made explicit by article 55 and was confirmed by a senior member of the Institute of Law of the Chinese Academy of Social Sciences in Beijing, who expressed with some confidence the view that "the basic principles of the forthcoming legislation will be the same as those set forth in the Economic Contract Law". Given the well-known preference of the Chinese for adopting their own laws and institutions to govern contracts entered into with foreign companies, this means that foreign companies that do business with Chinese enterprises may find themselves governed by provisions much like those in the Economic Contract Law.

Second, there is good reason to believe that the Economic

Contract Law will govern the "economic contracts" entered into by equity joint ventures involving Chinese and foreign investment. While the term "legal persons" in article 2 is not defined in the law, there is no doubt that such an equity joint venture will be a separate legal entity for Chinese purposes. To a company contemplating such a joint venture, therefore, the Economic Contract Law should be a relevant factor in deciding whether or not to go ahead.

Third, the Economic Contract Law sheds light on a number of important features of the Chinese economy: the interrelationship between the planned and unplanned sectors, the way in which business is conducted, the manner in which economic disputes are resolved, the extent to which the matter of entering into economic contracts is free from government control and last, but not least, the importance attached to contractual undertakings. A familiarity with these can only assist the foreign business person in his dealings with the Chinese.

With these considerations in mind, we turn now to a more detailed examination of the provisions of the Economic Contract Law. The statute contains a total of 57 articles and is divided into seven chapters:

- General Principles (articles 1-8)
- Formulating and Fulfiling Economic Contracts (articles 9-26)
- Change or Cancellation of Economic Contracts (articles 27-31)
- Responsibilities for Breaking an Economic Contract (articles 32-47)
- Mediation and Arbitration for Economic Contract Disputes (articles 48-50)
- Management of Economic Contracts (articles 51-53)
- Supplementary Articles (articles 54-57)

Most of the articles purport to be general in their application. There are, however, a significant number that are aimed at particular kinds of economic contracts. Thus there are special provisions for each kind of contract listed in the above-noted article 8 in both the chapter dealing with the formation and fulfilment of contractual obligations and in the chapter dealing with the responsibilities of a party in breach. These special provisions will not be the subject of comment here, except to note that their inclusion in this statute reflects the fact that special sets of regulations for particular kinds of economic contracts had been in place in China for many years, even if they were not enforced.[10] Our focus will be on the general provisions.

The Formation of an Economic Contract

To westerners, some of the most interesting provisions of the Economic Contract Law are those dealing with the formation of enforceable economic contracts. They are of interest primarily due to the strictness of the rules they prescribe. The first of these rules is found in article 3 and it stipulates that all economic contacts apart from spot transactions, must be in writing.[11] A westerner's initial reaction to such a rule is that it is unduly restrictive and has the potential to cause significant hardship. It must be remembered, however, that competition in the marketplace, even in the highly attenuated form in which it is now permitted, is a recent innovation in China. As such it is to be expected that its introduction would be tightly controlled. As well, even in the planned sector of the economy, where contracts have long been in use,[12] past experience indicates that the attitude towards both the making and fulfiling of contractual obligations was often far too casual. The requirement that economic contracts now be in writing is obviously an attempt to correct that situation. To the Chinese, therefore, the restrictiveness embodied in article 3 would be seen in positive rather than negative terms. This was indeed the case with the scholars with whom we spoke. The potential for hardship may also be of no concern to the Chinese. In cases where there was clearly an oral agreement as to the essential terms of an economic contract, the parties in question could presumably be required by their respective "units in charge" to reduce the agreement to writing. Once that was done, neither side would be able to avoid its obligations and the potential for hardship would disappear.

Another of the strict rules regarding the making of an enforceable economic contract is that one which is concerned with the use of agents. According to article 10, it would appear that the only way a principal can be bound by the actions of an agent is if the agent makes use of the actual authority given him by a "power of attorney". In other words, the law does not allow for the possibility of a principal being bound in situations in which he has expressly or by implication ratified the unauthorized actions of an agent or in situations in which it can be said that the principal gave the agent what in our law is called apparent authority to bind him. It should be noted that such a reading of article 10 is supported by article 7, which declares invalid inter alia any contract signed by an agent in excess of his authority and which stipulates that such a contract has "no legal binding force from [its] inception". By and large it was also supported by the scholars with whom we spoke.

There may, of course, be special reasons for such a restrictive approach to the binding of principals by the actions of agents in China. One scholar suggested that the Chinese system was such that agents simply did not act without first having obtained the requisite authority and that there was therefore no need for concepts like ratification and apparent authority in their law. This view was shared by another scholar, who noted that the practice often adopted when important agreements were being made by an agent who was not a senior official (or, as the Chinese put it, a "legal representative") of the enterprise, was for the agent to sign the contract "subject to the signature of the principal". Still another suggested that people in China were unlikely to deal with someone unless they had first confirmed their position and authority. From his perspective, ratification and apparent authority were unnecessary concepts.

It seems clear, however, that the drafters of the Economic Contract Law were alert to the possibility that, with the loosening of control over business activity, agents might in fact attempt to bind their principals in contract to third parties either ignorant of their lack of authority to do so or in the hope and expectation that such a lack would be remedied by way of ratification. Were this not the case there would have been no need for provisions like article 7 and article

10. One solution to these problems would have been to do what our law does: to recognize that principals will be bound by unauthorized action in cases where they subsequently ratify it or can be said to have given the agent the appearance of having had the requisite authority. The other solution, and one chosen by the Chinese, is to protect the principal from all liability in such cases, thereby placing a heavy onus on the third party to confirm the actual authority of the agent before dealing with him.

The reason for preferring this solution most surely lies in the tightly controlled nature of the Chinese economy. If principals could be bound in contract in situations where an agent acted without authority, the extent of that control would clearly diminish. By taking the approach they have, the drafters have ensured that control remains tight. It may well be that if the present trend towards greater reliance on the market economy continues in China, we will see amendments to the Economic Contract Law to permit principals to ratify and to hold them bound by apparent authority. For the present, however, it appears to be actual authority or nothing.

Before finishing a discussion of article 10, it is important to note that there is no requirement that an agent's "power of attorney" be in writing. As a matter of practice, it seems that the "legal representatives" of an enterprise are given their authority to act on behalf of the enterprise at the time of--and by the act of--their appointment. Other agents, it seems, commonly obtain their authority in writing. This is especially true in cases where the contract to be negotiated is of particular importance or of an unusual nature.

Another strict, or at least apparently strict, rule relating to the creation of binding contractual obligations is found in the combined effect of articles 9 and 12. Article 9 provides that "an economic contract is formulated when both parties concerned have achieved unanimity through consultations of the major articles of the economic contract according to the law." Article 12 defines the term "major articles" to include at least

- objective
- quantity and quality

- prices or commission
- time limit, place and method of fulfiling the contract
- responsibilities in case of violation of contract

and is worded in such a way that, like article 9, it appears to make agreement on all of the "major articles" necessary, as a pre-condition to the creation of a binding economic contract.

The scholars with whom we spoke were not inclined to interpret articles 9 and 12 quite so strictly. In their view, an agreement that did not contain provisions relating to each and every matter covered by the "major articles" might still be enforceable. To support this view, it was noted that the Economic Contract Law itself contains a number of provisions relating to "responsibilities in case of violation of contract", which could presumably fill any void left by the agreement in that regard.[13] It would, they suggested, depend on the facts of each case. Perhaps the test would be, as it is in our law, whether the parties had reached agreement on the terms that are essential in a contract of the particular nature in question. It was also suggested that article 12 was primarily intended to teach those with little experience in making economic contracts what it was that such contracts should contain.

From a policy standpoint, however, it probably makes good sense to impose strict requirements with respect to the contents of an enforceable economic contract. Not only does such an approach tend to minimize the likelihood of disputes between the contracting parties, it also discourages enterprises from entering into contracts that they may not have the ability to honour. These are especially important considerations in a country where experience with "freedom of contract" is likely to be very limited. The costs of such an approach--with greater time being spent in negotiations and possibly fewer agreements signed--would probably not be of much concern to the Chinese, at least at the moment. The more tightly controlled the experiment in "freedom of contract" the better. It may be, therefore, that this rule, too, will be applied strictly.

The next noteworthy provision in this category, article 11, concerns the making of economic contracts in respect of products and items included in the state's economic plans. Contracts on products and items included in the mandatory plans must be made in accordance with the targets set by the state. If the parties are unable to reach agreement on their own, "the higher organs in charge of planning of both sides" are charged with the responsibility of working out the details. Whether or not these will then be embodied in a contract that the parties will be required to sign is unclear. It may be that everything will be handled administratively. One suspects, however, that the signing of a contract will be required to ensure that the parties will be subject to the provisions in the Economic Contract Law relating to the obligations of a party in breach.[14] Contracts on products and items included in the guiding plans are to be made after due consideration of the targets set by the state and the "actual conditions" of the parties. The latter term is presumably a reference to the needs and capabilities of the respective parties.

The obligatory nature of these rules is reinforced by article 7, which declares as invalid these "contracts that violate the laws and state policies and planning". This article would almost certainly have the effect of rendering invalid a contract that was inconsistent with the provisions of a mandatory plan. Its implications for a contract that was inconsistent with the provisions of a guiding plan are not so clear. At the very least, however, its existence should discourage parties from ignoring the requirements imposed by article 11 in respect of contracts involving products and items covered by the guiding plans.

Before turning to the matter of changes in or cancellations of economic contracts, it is interesting to note what the Economic Contract Law has to say about the matter of guarantees. According to article 15, upon the request of one party to an economic contract, a guarantee "can be provided by a certifying unit that serves as an intermediate agent to guarantee that (the other party) will fulfil the contract." It goes on to provide that, in case "the guaranteed party fails to fulfil the contract, the certifying unit will be responsible for making up the losses incurred."

Article 15 is silent as to the requirements of an enforceable guarantee. It is not known, therefore, whether the guarantee must be in writing, whether it must be made to the party seeking it or whether it is sufficient if it is made to the party whose obligations are being guaranteed, whether it must be made at the same time as the contract itself and whether, to use our terminology, consideration must flow to the guarantor. However, the exposure of the guarantor is certainly made clear. In this regard, it is worth noting that the typical guarantee in China is given by the body which, according to the hierarchical structure of the Chinese economy, controls and is responsible for an enterprise's business activities. In the case of an industrial or commercial enterprise this is likely to be what amounts to a holding company that looks after several enterprises engaged in the same general kind of business and which itself is under the control of a governmental bureau or ministry. The purpose of such a guarantee is not simply to promise to cover a monetary debt, but as article 15 suggests, to guarantee the performance of whatever it is that the party in question has contracted to perform, including production and delivery. In a very real sense, the guarantor under such an arrangement becomes a party to the original contract, directly liable under it in the event of default by the party for whom it is responsible.

What article 15 essentially does, then, is to confirm common practice as the legal rule. Whether or not it would be capable of accommodating different kinds of guarantees--for example, one in which an independent third party would simply guarantee the payment of money with no responsibility being undertaken for the payment of compensatory damages--is a matter of speculation. Such speculation may be idle at the present time, for the simple reason that such guarantees are apparently not now either sought or given. With the growth of a private sector, however, room may have to be found for such alternatives.

Variation and Cancellation

From the provisions relating to the creation of an enforceable economic contract we move to the provisions relating to changes in, or cancellation of, an existing economic contract. The most interesting feature of these provisions is the extent to which they reflect the importance of fulfiling one's contractual obligations.

Article 27 describes five circumstances in which an economic contract can be either varied or cancelled. The first of these is when the parties themselves agree to the variation or cancellation, provided the variation or cancellation does not "harm state interests or affect state plans". It is clear that, not only in the making of economic contracts but also in the variation and cancellation of such contracts, the wishes of the parties are clearly secondary to the interests of the state, and in particular to the state plans. The freedom to remake or unmake an economic contract is as much circumscribed as the freedom to make it.

The second circumstance in which variation or cancellation is permitted is "when the state plan on which the contract is based has been revised or cancelled". As drafted, article 27 would appear to leave it in the discretion of the parties as to whether or not their contract should be varied or cancelled as a result of a revision in or cancellation of the plan on which it is based. However, it seems highly unlikely that this was intended. The language of the aforementioned articles 7 and 11 of the Economic Contract Law would appear to make a variation or cancellation obligatory when a mandatory plan is revised or cancelled, and at the very least desirable when a guiding plan is revised or cancelled. In fact, it seems probable that a contract that is not varied or cancelled in accordance with a revision in or cancellation of a mandatory plan would be held invalid under article 7, since from the time of the revision or cancellation, the contract would be in violation of state planning.

Economic contracts can also be varied or cancelled "when one party (to) the contract can no longer fulfil the contract because the plant or enterprise has closed down, stopped production or been converted to other uses". How often this provision will be invoked is, of course, unclear: no doubt the Chinese hope that it occurs very seldom. Presumably, if the upper echelons within the economic hierarchy do their jobs well, plant shutdowns and conversions will be planned well in advance and the enterprises involved given sufficient notice of these plans. If this is done, the harmful effect such shutdowns and conversions can have on the ability of contracting parties to fulfil their obligations will obviously be minimized.

The final two circumstances in which variation or cancellation is permitted are formulated in somewhat ambiguous terms, but can perhaps best be described as situations of force majeure and frustration. The former term is familiar enough. The latter term can perhaps best be defined in terms of a change in circumstances that renders the contract legally or physically impossible of performance. Neither of these two provisions reveals anything particular about the structure or workings of the Chinese economy. It is, of some significance, however, that as legal concepts, they are familiar to the Chinese.

Having set out the circumstances in which variation or cancellation is permitted, article 27 proceeds to lay down a rather surprising rule: it states that the party that "causes" a variation or cancellation is liable to the other party for any losses the latter suffers as a result of it. It seems clear for a number of reasons,[15] that the term "causes" is here used in the sense of "initiates" or "seeks" rather than "is to blame for". The rule is, therefore, a harsh one. Some of that harshness is mitigated by article 34, which grants a conditional immunity to those victimized by a force majeure, and by article 33, which permits claims against the "leading bodies" and "units in charge" of parties caught by the rule in cases where fault lies with those bodies. It is also conceivable that the provisions of the forthcoming Civil Code might further mitigate the harshness by allowing for claims in other situations as well. Be that as it may, the rule emphasizes the importance the law attaches to the fulfilment of one's contractual obligations. Failure to perform, for whatever reason, is clearly viewed in the most unfavourable of terms. The reasons for this will be explained in the next section.

Liability for Breach

We come now to the matter of responsibilities for breaking an economic contract. The basic rule, established by article 32, is that liability goes with fault. This is of course, to be expected. There are, however, a number of interesting rules in this area as well.

The first of these are found in article 35. That article makes it clear that if the party not in breach "demands continuous fulfilment of the contract, the responsible party must comply". In other words, to use language that we would be familiar with, specific performance is the preferred remedy for breach of contract. The reasons for this preference, which is a long-standing one in China, are well expressed in the following passage:

> In China, (in contrast to the industrialized western countries), the economy is one of scarcity. Therefore, goods are not freely available and money is not easily convertible into desired goods. In this sense goods "contracted" for may be considered unique. Moreover, under planning the allocation of resources and products enhances the character of uniqueness as natural scarcity is intensified by planned scarcity, i.e., planned balances under which there is no surplus of supply over demand. . . .
> In addition, the emphasis on "contracts" in China primarily as a device for implementing and supplementing the national plan reinforces the demand for specific performance of obligations. Because of planning, the state's interest in the performance of each contract is immeasurably increased. Only by specific performance of obligations can the plan be fulfiled. Substituted performance--damages--will not satisfy the production needs of the obligee. And, as a result of that failing, the obligee himself will be unable to perform his obligations in realization of the plan, thereby adding a link to the chain of failures to achieve the plan that must follow a failure to specifically perform any "contract" under the plan.[16]

One of the more interesting questions to arise out of the Economic Contract Law is, of course, whether or not specific performance will remain the preferred remedy for breaches of contract in the small private sector of the Chinese economy. If the reasons for the preference disappear, will the preference itself not do likewise?

In addition to making provision for specific performance as the preferred remedy, article 35 stipulates that a party in breach is required to make "a penalty payment" to its opposing number. Furthermore, if that penalty payment is insufficient to cover the losses suffered by the other party, a damage award will be ordered to make up the difference. Article 35 is not clear as to whether or not a penalty payment is due even when no losses have been suffered. Nor is it clear as to whether or not a penalty payment and, if necessary, damages can be claimed in addition to the remedy of specific performance. However, if past practice is to be the guide, it is likely that a penalty payment is due even though no losses are suffered. Furthermore, it seems that a penalty payment and damages can be claimed in addition to specific performance.

Reliance on penalty payments as a remedy for breach of an economic contract makes sense in an economy where the fulfilment of contractual obligations is so important, for such payments function primarily as a deterrent to breach. While no obligation to include provision for such a payment is clearly spelled out in the Economic Contract Law, it may be implicit in the aforementioned requirement of article 12 that economic contracts include a clause setting out each party's "responsibilities in case of violation of contract". Such a reading would again be consistent with past practice, at least in the case of contracts for products and items included in the state plans. In the case of other contracts, such a provision may be optional.

Although obviously not the preferred remedy, as they are in the common law countries, damages are by no means unimportant in the Chinese scheme of things. In fact, with the continuing emphasis on the need for strict financial accountability on the part of all enterprises, damages play an important role. From the standpoint of the party in breach, a damage award both signals to the authorities a failure to perform one's contractual obligations and cuts into profits. This latter consequence is mandated by article 37, which stipulates that penalties and damages must be paid out of profits "and must never be included in the enterprises's production costs."[17] And from the standpoint of the party not in breach, a damage award both ensures that it is not blamed for the default and protects the level of profits that it would otherwise have earned.

The final noteworthy rule in this category has, in fact, already been mentioned: the rule that gives a party in breach the right to claim over against "a leading body at a higher level or the concerned unit in charge" in cases where that party's inability to perform is attributable to the fault of that leading body or concerned unit. Just how high up the ladder this provision gives the party in breach the right to go to seek indemnification is unclear. For example, it is not clear that it would entitle the party in breach to seek indemnification from those responsible for making up the economic plans in a case where such plans had to be changed due to mistakes in the original versions and those changes resulted in the breach. If it did, as in fact at least one group of scholars construed it as doing, this provision would presumably have a direct and significant impact on the quality of economic planning in China. Even if it did not extend this far, however, the policy underlying it is an important one; namely, that losses arising out of a breach of contract should be borne by the entity that was, in fact, responsible for the breach. The principle of economic accountability is clearly being taken very seriously.

Dispute Resolution

The important matter of dispute resolution is dealt with in articles 48 to 50. The first of these provisions stipulates that in cases where the parties cannot resolve their dispute through "consultations" with each other, either party can select any one of three options: mediation, arbitration, judicial adjudication.

The first two of these processes are to be handled by "the organ governing contracts assigned by the state" and the last by the people's courts. According to article 49, a dispute is considered resolved if mediation proves successful. However, if either party is unhappy with the award of an arbitrator, that party can "bring a suit at the people's court within 15 days after receiving the written judgment". One presumes that once one enters the court system, either directly or following an arbitrator's decision, the normal rights of appeal would be available. This would mean that each party would be limited to one appeal.

Those with any familiarity at all with either traditional or modern Chinese law will know that the Chinese prefer not to have their disputes adjudicated. One therefore suspects that mediation will be the preferred mechanism of dispute resolution under the Economic Contract Law, at least initially. This means that the identity of "the organ governing contracts assigned by the state for mediation and arbitration" is of considerable importance. Primary responsibility for the mediation and arbitration functions has been given to the General Administration of Industry and Commerce and to the local bureaus thereof, the bodies which have in fact been given primary responsibility for overseeing the implementation of the whole of the Economic Contract Law.[18] However, it appears that that is not the only body that will be performing such functions. In fact, much of the mediation and arbitration work will be done, as it has been done in the past, by personnel within the various industrial and other ministries, at least in cases where the dispute is between two enterprises in the same ministry. Other organs may be involved as well in the performance of these functions.[19]

To the Western-trained legal mind, the use of several different agencies to mediate and arbitrate disputes arising under one statute would be cause for considerable concern. Not only is there a risk under such a system that the parties involved in a dispute may waste time and effort determining where it is they are to turn for a resolution of that dispute, but also the treatment accorded such disputes by the different agencies is liable to be uneven. However, according to the scholars with whom we spoke, in China such considerations are outweighed by others that argue in favour of the system that has been adopted.

The first, and perhaps most important, of these is the need to preserve a close relationship between the links in the chain of command through which the economic plans are carried out. Given that one of the stated purposes of the Economic Contract Law is to "guarantee the implementation of state plans", it makes eminent sense in the eyes of the Chinese to give the various ministries first crack at the resolution of disputes between enterprises under their control.

The second countervailing consideration is the desire to allow for flexibility on a regional basis. In this regard, it was noted that article

56 empowers the "various provincial, municipal and autonomous regional people's governments to work out regulations to implement this law", subject to the approach of the State Council. This article, which appears to have its origins in a concern about the differing degrees of business as well as legal sophistication in the various parts of the country, provides clear authority for the establishment of schemes tailored to suit the needs of particular regions. As one of their elements, it was said, these schemes could well involve a special provision regarding mediation and arbitration.

The third and final consideration advanced is that of limited human resources. At the moment no agency, including the General Administration of Industry and Commerce, has a sufficient number of trained personnel to allow it to handle all the disputes that arise under the Economic Contract Law.

The notion that ministry personnel should be performing mediation and arbitration functions gives rise to another quite separate concern about the system of dispute resolution that has been established. Such personnel are unlikely to be viewed by the disputing parties as entirely independent, if for no other reason than the existence of the article that permits claims against "the concerned unit in charge." In some cases the ministry may be party and judge in the same cause. While justice may in fact be done in each such case, it will not always be seen to have been done.

The Chinese we spoke to were certainly conscious of the value of having independent decision-makers for disputes under a statute like the Economic Contract Law. However, it is clear that they consider the maintenance of a close relationship between the various links in the chain of economic command to be more important. Furthermore, it was emphasized that the system allows for disputes to be taken directly into the court system and for appeals to be taken from arbitration awards to the courts.

"Management" of Economic Contracts

The provisions in this chapter of the Economic Contract Law are of particular interest to the foreign observer for they are directed to a practice not found in Western countries: government "management" of the making and carrying out of contracts. Primary responsibility for the performance of this function has been given to the General Administration of Industry and Commerce and to the local bureaus thereof. In addition to mediating and arbitrating disputes, these bodies have been given the tasks of surpervising and inspecting the economic contracts signed between different departments to ensure their validity, investigating "illegal" contracts and punishing those responsible,[20] and supervising the systems established by the various ministries and other governmental organs to manage the economic contracts entered into between parties under their respective spheres of control.

An important element in this contract management system is the "verification" process. A voluntary process used primarily in cases where the parties have significant room within which to bargain, verification involves the parties having their contract examined to ensure that it is clearly worded, covers all the material terms and conditions, does not contravene any legislation, state policies or plans, and is capable of being performed by both parties. Although it carries no legal significance, verification clearly performs a useful practical function in a country in which many people have had little experience in legal matters. It ensures that contracts that for one reason or another should not be entered into are in fact not entered into. It also means that in the event of a dispute at some later time about the meaning of a particular term or provision, a more or less independent third party will be able to interpret the parties' understanding at the time the contract was made.

Article 52 makes special provision for the supervisory role to be played by China's financial institutions. These bodies--"the People's Banks, specialized banks and credit co-operatives"--are required to "supervise the implementation of economic contracts through the management of credits, loans and accounts" and to "handle cases such as payment on order, payment refusal, payment deduction and delayed payment". The significance of those roles is made clearer by article 13, which stipulates that "unless the state allows the use of cash in fulfiling obligations, all accounts should be transferred through the banks". Moreover, these bodies are required to ensure that mediation agreements, arbitration awards, and court decisions are enforced. Upon receipt of notice from a people's court asking them to do so, they are obliged to "deduct payments from the litigants' accounts or transfer funds from such accounts to make payments". Clearly, financial institutions in China are not viewed as independent entities in the commercial world: they are in a very real sense an arm of the state. Foreign companies take heed!

Conclusion

One should not assume from the above discussion that all economic dealings in China are now being conducted in strict accordance with the provisions of the Economic Contract Law. In fact, the implementation process has been, and will continue to be, a gradual one, with the large enterprises in the major centres the first to be brought within its scope and the smaller enterprises in the smaller centres likely to be the last.[21] There are basically two reasons for this, both of which have been hinted at already. The first is that it is necessary to give Chinese enterprises, many of whom have until now been subject to little if any strict legal regulation, the time to familiarize themselves with the provisions of the new law. Enterprises must be taught, for example, what is required of them in order to create an effective, binding contract otherwise they may find the agreements they think they have made to be unenforceable. Similarly, they must be taught the consequences of a failure to perform, otherwise they may find themselves saddled with penalty payments and damage awards they cannot absorb. In this regard, the Chinese are frank in acknowledging that the six-month period between the date on which the Economic Contract Law was promulgated and the date on which it became effective was not sufficient to ensure that the requisite level of understanding of its provisions was attained throughout the system.

A serious shortage of trained administrative and judicial personnel is the second reason. Eventually it is expected that all enterprises wanting to make use of the "verification" process will be able to do so. At the moment, however, it is impossible to provide the service to more than a few. The ability of the bodies charged with the responsibility of mediating and arbitrating disputes is also limited, as is the ability of the court system to discharge its functions. In this regard it is interesting to note that civil cases tend not to be treated as seriously as criminal cases by Chinese judicial personnel. At a recent conference on civil law, Jiang Hua, president of the Supreme People's Court, was moved to state that "all kinds of erroneous viewpoints looking down on trials of civil cases must be eliminated."[22] No doubt such "erroneous viewpoints" reflect the traditional Chinese view that such disputes should not have to be litigated.

Even when the law is properly enforced throughout the country, it may be some time before it truly takes hold. One of the major problems, according to one group of scholars, will be that of breaking experienced business people of old habits and customs. For example, those who have developed strong personal relationships with their counterparts at other enterprises, relationships from which both sides have benefited in the past, may feel that those relationships will be strained if detailed written contracts replace the informal understandings that have worked well until now. Similarly, those who have acted more or less on their own in making commitments on behalf of their enterprises may be reluctant to subject their activities to the scrutiny of others to ensure that they comply with the provisions of the Economic Contract Law. Finally, and perhaps most importantly, entities which have been accustomed to dealing with each other administratively--as has apparently been the case when enterprises deal with scientific or administrative units--may be unwilling to change over to using formal contracts.

In spite of these problems of implementation, the Economic Contract Law is clearly a major component of China's burgeoning new legal system. While its thrust is obviously domestic rather than foreign, it is a statute that foreign business persons with an interest in China would do well to examine, not only because of its direct relevance to business activities, but also as it provides considerable insight into a number of features of China's remodelled economy about which the wise business person is going to want to be informed.

Notes

1. 31 January 1967 (cited in Victor H. Li, "The Role of Law in Communist China") The China Quarterly 44 (1970), 108.
2. Beijing Review, 29 December 1978, 6 at 14.
3. Foreign Broadcast Information Service, Daily Report: People's Republic of China, 25 August 1982, K13 (hereinafter cited as FBIS). It is interesting to note that 65 per cent of the over 4,000 laws and regulations enacted prior to 1958 concerned economic matters; see Hsiao, "The Role of Economic Contracts in Communist China" (1965), 53 Calif. L. Rev. 1029, at 1030.
4. FBIS, 15 September 1982, K14.
5. According to Liu Fuzhi, the Chinese Minister of Justice, "around 150 more economic regulations are now being drawn up" (FBIS, 25 August 1982, K13). The major laws being drafted include a corporation law, a factory law, a patent law, a law of accounting, a law of costs and a law of depreciation on fixed assets (FBIS, 9 December 1981, K3).
6. See, for example, Shen Shiao-Ming, "China's New Law on Joint Ventures Using Chinese and Foreign Investment" (1981), 34 Sw. L.J. 1183; Paul D. Reynolds, "The Joint Venture Law of the People's Republic of China: Preliminary Observations" (1980), 14 Int'l Lawyer 31; P.M. Torbert and J.A. Thomson, "China's Joint Venture Law: A Preliminary Analysis" (1979), 12 Vand. J. of Trans'l L. 819.
7. It is important to note that, according to article 54, "individual businessmen and rural commune members should sign economic contracts with juridical persons with reference to this law." The law does not apply, therefore, only to artificial legal persons.
8. Article 53.
9. For example, in the case of a purchase and sale contract, the packaging, inspection and transport details.
10. New sets of such specialized regulations are in the process of

being enacted for some thirteen different kinds of economic contracts. The special provisions now found in the Economic Contract Law for the ten kinds of contracts named in article 8 are therefore somewhat general in nature.

11. Article 3 makes it clear that "documents, telegrams and charts" will count as part of the contract (assuming of course that they are intended to be).

12. For a discussion of the use of contracts in the pre-Cultural Revolution period, see Hsiao, "Role of Economic Contracts"; Richard M. Pfeffer, "The Institution of Contracts in the Chinese People's Republic: Part I" in The China Quarterly 14 (1963), 153 and "Part II" in The China Quarterly 15 (1963), 115; and Stanley Lubman, "Methodological Problems in Studying Chinese Communist 'Civil Law' " in Contemporary Chinese Law: Research Problems and Perspectives, edited by Jerome Al Cohen, pp. 230-60, (Cambridge, Mass.: Harvard University Press, 1970).

13. On the assumption that "responsibilities in the case of violation of contract" is intended to refer to the amount of penalty to be paid on breach, this reasoning is faulty. While article 35 does make provision for penalty payments, it clearly assumes that the contract itself stipulates the actual amount. However, the amount has traditionally been set by regulations for contracts covered by the plan, so, at least insofar as those contracts are concerned, the Chinese scholars may have been right for the wrong reasons.

14. This has been the case in the past; see Hsiao, "Role of Economic Contracts", 1046.

15. These include (1) when the drafters of the Economic Contract Law mean "responsible for" in the sense of "to blame for", they use words to that effect and (2) otherwise article 27 would seem to be redundant since articles 32 and 35 deal with liability in the case of fault.

16. Pfeffer, "Institution of Contracts, Part II", 125-6.

17. If the party in breach has insufficient funds to satisfy the penalty payment and damage award, it may seek relief either

from the "unit in charge" (which is unlikely to want enterprises under its control to default) or from a financial institution (by way of loan). One group of scholars suggested that the problem of insufficient funds was unlikely to arise, however, because the financial institutions in China have a supervisory role to play in the making of economic contracts and therefore will be in a position to advise an enterprise not to overextend itself by entering into a particular agreement. Presumably insurance would be available as well.

18. The General Administration of Industry and Commerce is responsible for administering a wide variety of economic activities and laws, including advertising, the registration of joint ventures, trademark registration and the "individual businessman" sector. Until 1956, this body was responsible for administering the private sector of China's economy, in a sense playing the role of a commercial police force. With the demise of the private sector, however, it lost much of its importance. It is only now being revived.

19. The actual division of responsibility in this area (and in others in which such a division exists--in the area of contract "verification" for example) was never made very clear to us, possibly because it had yet to be finalized. However, according to a senior member of the Law Institute at the Chinese Academy of Social Services, the division was approximately as follows as far as centrally controlled businesses were concerned:

    - where the contract is between two parties under the control of a particular ministry, any disputes are handled by ministry personnel;
    - where the contract is between parties under the control of two different ministries, any disputes are handled by personnel within the State Economic Commission; and
    - where the contract is between parties within different sectors (i.e., Industry-Commerce, Industry-Agriculture, or Commerce-Agriculture), any disputes are handled by the General Administration of Industry and Commerce.

Whether or not this is an accurate description of how the division of repsonsibility finally turned out, I do not know.

20. This is a reference to the article referred to in footnote 8, article 53.
21. People's Daily, 27 June 1982.
22. FBIS, 13 July 1982, at K12.

17: CANADA, INTERNATIONAL TRADE, AND THE ECONOMICS OF CO-OPERATIVE FISHERIES ARRANGEMENTS

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CANADA, INTERNATIONAL TRADE, AND THE ECONOMICS OF CO-OPERATIVE FISHIERS ARRANGEMENTS

Introduction

Regardless of whether or not the Third United Nations Conference on the Law of the Sea is ultimately deemed to have been a success overall, there is no question that the conference will be deemed to have had a major, if not revolutionary, impact upon the management of world fisheries. Coastal states such as Canada have, as a consequence of the conference, acquired control over large fishery resources that hitherto were international common property. These newly acquired resources were in many instances exploited in the past by what the United Nations chooses to call distant-water nations, which can be defined simply as nations whose fishing fleets exploit fishery resources far beyond their own waters. Japan and the Soviet Union are obvious examples. One important aspect of the management of the newly acquired fisheries faced by Canada and other coastal states is the role, if any, to be assigned to the fleets of distant-water nations in the exploitation of these resources.

Throughout the paper we shall use the term "co-operative fisheries arrangement" to describe any arrangement in which distant-water fleets are invited by a coastal state to participate in any aspect of the harvesting of a coastal state fishery resource or the processing of the harvests from such a resource. Hence we shall apply the term to any joint venture, as it might be termed--any arrangement in which a distant-water fleet co-operates with coastal state entities in the exploitation of a coastal state fishery resource. Thus, as is true in the hake fishery off Vancouver Island, distant-water vessels with processing capacity may receive for processing fish harvested by coastal state vessels. Conversely, as has been true in Atlantic Canada, distant-water vessels may harvest coastal state fishery resources and deliver the catches to domestic processing plants. We shall also apply the term to fee fishing, in which a distant fleet both harvests a coastal fishery resource and processes the catch in return for a payment in cash or kind to the coastal state.[1]

The economics of co-operative fisheries arrangements as seen from the perspective of the coastal state[2] are for the most part, the economics of international trade. When a coastal state enters into such an arrangement it is, we shall argue, importing harvesting and/or processing services from a distant-water nation or nations. Thus, one can maintain that the Law of the Sea Conference has created a new set of potential trade relations for Canada and other coastal states.

The economic arguments in favour of the arrangements prove to be no more than variants of the argument for free trade. Similarly, the arguments opposing these arrangements are actually arguments that favour the protection of various sectors of the coastal state fishing industry.

Prior to discussing the economics of co-operative fisheries arrangements and their relationship to the economics of international trade, however, it is necessary to examine the effect of the Third Law of the Sea Conference on world fisheries management. In particular it is necessary to examine what specific rights the coastal states gained with respect to their newly acquired fisheries and what concessions they were obliged to make to the distant-water nations. We turn then to consider that part of the Law of the Sea Convention that relates to fisheries.

The Third Law of the Sea Conference and Fisheries

The controversy that had enveloped the Law of the Sea Conference during its last few years centered around the issue of deep sea mining.

The issue of fisheries proved, in contrast, to be a relatively easy one to settle. The first formal session of the Law of the Sea Conference was held in the summer of 1974. By the end of the second session in the spring of 1975, the fishery questions had been fully resolved.

The central agreement at the conference was that coastal states should be given the right to establish zones of jurisdiction over fishery resources out to 200 miles from their coastlines. Prior to the conference, Canada had laid claim to fishery resources within 12 miles of her coasts. Fisheries beyond the narrow range control of the coastal state were international fisheries and were subject to the control of international organizations or were subject to no control whatsoever. Thus, for example, the great fishery resources on the Grand Bank off Newfoundland[3] were almost entirely international fisheries and were heavily exploited in the early 1970s by distant-water fishing nations. The single most important fishery resource on the Grand Bank consists of cod. In the mid-1970s, almost 70 per cent of the Grand Bank cod harvest was accounted for by distant water nations such as the Soviet Union and Spain.[4]

The resolution of the fishery issues at an early stage of the Law of the Sea negotiations prompted coastal states to implement unilaterally the Extended Fisheries Jurisdiction (EFJ) long before the convention was ready for signing, let alone ratification. Canada, for example, formally implemented EFJ on 1 January 1977, while the United States followed two months later. The implementation of EFJ has become so widespread that should the convention be unsuccessful during the now current ratification state, the convention's fishery provisions would at the very least remain as customary international law.

The key articles pertaining to fisheries in the convention are articles 56, 61, and 62. The coastal state zone established upon the implementation of EFJ is referred to as an Exclusive Economic Zone (EEZ). Under the terms of article 56, a coastal state is granted not merely management rights over the fishery resources within its EEZ, but also de facto, if not de jure, ownership or property rights. The article states that the coastal state has "sovereign rights for the purpose of exploring and exploiting, conserving and managing the resources, whether living or non-living"[5] in its EEZ. Thus, to return to our Canadian example, the fishery resources on the Grand Bank, hitherto international in nature, are now (with certain qualifications) subject to Canadian ownership.

The coastal state's ownership rights are, of course, qualified in those instances where the fishery resources move between or straddle the coastal state's zone and that of a neighbouring coastal state. They are also qualified in those instances where the resources move between the coastal state's EEZ and the high seas. Both Canada's Pacific and Atlantic coastal zones provide examples of the former; her Atlantic coastal zone provides a clear example of the latter with the Grand Bank.

The convention appears to introduce as well a general qualification to coastal state ownership rights and to do so as a concession to the distant-water nations. Under article 61 of the convention, the coastal state is to determine for each fishery resource within its EEZ an appropriate total allowable catch on a per-fishing-season basis. Under article 62 the coastal state must then, for each such resource, take into account its harvesting capacity. The difference between the coastal state's harvesting capacity and the Total Allowable Catch (TAC) constitutes a surplus to which the coastal state must give distant-water nations access.

The qualification is much less important than it appears at first glance, however. Article 62 permits the coastal state to impose a wide range of terms and conditions upon distant-water nations seeking access to these surpluses. In no sense is the coastal state expected to distribute harvest rights free of charge. Legally, there is nothing to prevent a coastal state from setting surpluses equal to zero.[6] The coastal state could eliminate a given surplus either by building up its harvesting capacity or by reducing the TAC.

It is probably true that a coastal state would find it difficult from a politicial point of view to move immediately towards very low TACs as a means of eliminating surpluses. Such action would certainly invite poaching by angered distant-water fleet owners, the prevention of which could prove costly to the coastal state. Nonetheless, gradually and by degrees the coastal state could eliminate surpluses by building up its harvesting capacity and by imposing access conditions upon distant-water nations which, although not demonstrably unfair, could serve to undermine distant-water nation interest in the surpluses over time.

In summary, coastal states have, with certain qualifications, acquired virtual ownership rights over the fishery resources within their recently established EEZs. While the coastal states are obliged to grant distant-water nations limited access to these resources, the obligation is in fact temporary in nature. If a coastal state such as Canada perceives that it is enjoying no benefit from distant-water fleet activity within its EEZ, then such activity will certainly be phased out over time.

The question of whether coastal states can expect to enjoy any ongoing benefit from distant-water fleet activity within its EEZ leads us to a consideration of the economics of co-operative fisheries arrangements.

The Economics of Co-operative Fisheries Arrangements: The Coastal State Perspective

The economics of co-operative fisheries arrangements are essentially a blend of the economics of fisheries management and the economics of international trade. The international trade aspects of the issue cannot be understood until one has an appreciation of fisheries management. Hence, we begin with a brief overview of the economics of fisheries management.

Fishery resources, like forestry resources, but unlike mineral and hydrocarbon resources, are capable of growth. As a consequence they can be harvested on a sustainable basis. The object of resource management is often expressed in terms of achieving the optimal sustainable yield (OSY) for the given resource. Indeed, articles 61 and 62 of the Law of the Sea Convention admonish the coastal state to do just that for the fishery resources under its control.

Achieving the optimal sustainable yield implies that the benefits to be derived from the fishery are being maximized. An important question then is whose benefits are to be the object of management. It would be utopian to suppose that the coastal state would focus on anyone's benefits other than its own. Having agreed on this, however, one then has to go further and ask how the coastal state benefits are defined. Are they to be benefits enjoyed by the domestic fishing industry, the fishing regions of the country or the nation as a whole? In the case of Canada, the answer has been provided by a policy document issued at the dawn of EFJ by the federal government, the body ultimately responsible for the management of Canadian fisheries. The document states that "the federal government proposes. . .to ensure that fisheries development is managed in the best interests of Canadian society", thus in the best interests of the nation as a whole.[7]

With the nature of the appropriate benefits defined, one next has to recognize that, unlike several other renewable resources such as forestry, the management of fishery resources is made very difficult by virtue of the fact that the resources are invariably common property. Fish are difficult to observe except upon capture and, more often than not, are highly mobile. Consequently, the cost of attempting to establish property rights in most instances far exceeds the benefits that might be derived therefrom.[8]

The consequences of the common property nature of the resource are as follows. The sustainable yield or harvest in most fisheries is a function of the size of the fishery resource or biomass. If a fishery having commercial potential is subject to no governmental controls, then the resource will be subject to excessive depletion in the sense that the sustainable yield will be far below the optimum set by society as a whole. In some instances the fishery resources could be threatened with extinction. British Columbia salmon and herring are cases in point. The reason for the excessive depletion are straightforward. As these are common property resources, no fisherman or fishing company has any incentive to conserve the resource: a fisherman who refrains from harvesting can expect to benefit only his competitor fishermen.

It has thus long been recognized that extensive government involvement is required simply to conserve the resources. As well, it has come to be recognized that resource conservation alone is not sufficient. If the government stabilizes a fishery resource at a particular level by imposing restrictions on the total harvest per year, but does nothing to limit the number of fishermen competing for the harvests, then the economic benefits that the fishery might provide society will be dissipated. The number of fishermen and vessels engaged in the fishery will tend to exceed by a wide margin the number required to take the allowable harvest. The Pearse Commission report on Canada's Pacific fisheries estimates that the British Columbia salmon fleet is, at the very least, twice as large as is needed to take the allowed annual harvests.[9] Hence there exists a further reason for government involvement in the fisheries.

As a result of the common property problem, the involvement of the government in the fishing industries tends to be considerable in comparison with that of other industries. In Canada, where the federal government is wholly responsible for the harvesting sector of the fisheries, it is estimated that, federal government expenditure on fisheries in the late 1970s was in excess of 20 per cent of the gross value of the harvests.[10]

In order to maximize the benefits that society derives from a fishery or, more precisely, to maximize the present value of net social benefits from the fishery over time, two sub-goals must be achieved simultaneously. The first is that any given level of harvest be taken, and the processing of the harvested fish be done, at minimum cost: redundancy of labour and capital in the industry must be avoided. The second is that the authorities build up (or deplete) the resource to such a level that the optimum sustainable yield is achieved. The optimum sustainable yield will be influenced by the costs of fishing, the prices for harvested fish or fish products, the rate at which society discounts the future and other factors. It will not be stationary over time.[11]

There are several factors that the resource managers need to consider when attempting to achieve these sub-goals, the first being the regulation of rebuilding. If a fishery resource has been subject to undue depletion in the past and consequently should be rebuilt, the question will then arise as to how rapidly it should be rebuilt. The most rapid rebuilding will occur if a harvest moratorium is declared during the rebuilding phase. Alternatively, the authorities can allow some harvesting to occur during the rebuilding phase so long as it is less than sustainable yield. The closer the harvest rate is to sustainable yield the slower will be the rebuilding.

Second, the authorities consider that species interact with one another. This may occur because species compete for the same food resource or because there are predator-prey relations between or among them. Even if the species are distinct in the environment, the vessels harvesting them may do so on a multiple species basis. A good example is provided by trawl fishing, in which a net is pulled behind the vessel, capturing everything in its path. While the vessel may be "targeting" a particular species, it is inevitable that it will have a "by-catch" of other species as well.

Next, the economic management of the fisheries is often complicated by the fact that many of the vessels (and fishermen) are specialized and hence limited to a restricted number of fisheries. Consequently, when they are not operating in their limited fisheries, they are idle. This problem is characterized in terms of the "malleability" or lack of capital involved in the fishery. The problem is pervasive among fisheries.

Finally, management of fishery resources is subject to substantial biological as well as economic uncertainties. The resource is difficult to measure at any given point in time. The resource may be subject to wide fluctuations over time due to unpredictable environmental shocks.

If it is possible for coastal state managers to grant access to distant-water fleets, this can influence the achievement of both sub-goals. It will, however, have the greatest effect upon the achievement of the first sub-goal.

If the opportunity exists to acquire the services of distant-water fleets, then achieving the first sub-goal (minimizing cost) obviously involves more than curtailing redundant domestic capital and labour in the fishery: comparing the costs of alternative sources of harvesting and processing services is also involved. We illustrate with a simple example of a coastal state groundfish fishery--cod--in which harvested fish is processed into filet blocks and sold in the world market. Let us assume that the fish can be processed either onshore or offshore in factory ships. Furthermore, let us say that for a given level of harvest, domestic costs (in Canadian dollars), as expressed on a per-kilo-of-raw-fish basis, are as follows:

∘	Harvesting	\$0.50
∘	Processing Onshore	\$1.30
∘	Processing Offshore	\$2.00
∘	Resource Management	\$0.10

Next, let us assume that the gross value of a kilo of raw fish after processing is \$2.10. Finally, assume that the domestic costs reflect the opportunity cost of labour and capital[12] and that the resource management costs are independent of the size of the harvest and of the presence, or lack thereof, of distant-water fleets.

If the resource were to be exploited on a solely domestic basis the net benefit or return to society--the resource rent--would be \$0.20 per kilo of raw fish, whatever the level of harvest. The rent could be increased if there were some sort of joint-venture arrangement in which a distant-water fleet harvests the resource and delivers the harvest to onshore plants--so long as the price paid to the foreigners for landed fish was less than Cdn. \$0.50 per kilo. Under such an arrangement, the coastal state would obviously be importing harvesting services from the distant-water nation (or nations).

The rent to society from the resource could also be enhanced if there was an alternative form of joint-venture arrangement set up--such as one popularly referred to as "over the side sales", in which domestic vessels harvest the resource and deliver the catch to offshore foreign processing vessels, providing the price received for raw fish was greater than \$0.80 per kilo. In this instance, the coastal state would be importing foreign processing services in a less obvious way.

Finally, the resource rent could be enhanced if the distant-water fleet was permitted to supply both harvesting and processing services, providing the fee paid by the foreign fleet was in excess of $0.30 per kilo. That option, which would best enhance society's resource rent, would be the most appropriate one in terms of the first sub-goal--minimizing costs.

One further point deserves brief mention. If a coastal state invites distant water nation participation in its fisheries, it may gain in terms of revenue as well as costs. A prospective distant-water nation may impose significant trade barriers against imported fish and fish products, with the consequence that the price of fish products in the domestic markets reach a level well in excess of world prices. By entering into a co-operative arrangement with the distant-water nation, the coastal state may be able to surmount the trade barriers and thereby enjoy above-world prices for its products.

The relevance of distant-water fleets to the second sub-goal--that of achieving OSY--is as follows. In many fisheries, the cost of harvesting, and possibly the cost of processing, will be influenced by the size of the resource or biomass. When this is dense, for example, less time will have to be devoted to searching for the fish and hence the costs of harvesting will be lower.

If the authorities have the choice between a high-cost, exclusively domestic option and a lower-cost option involving some foreign participation, and if they choose the high-cost domestic option for political or other reasons, the resource management program can be affected. It is easy to demonstrate that as the costs of labour and capital involved in exploiting the resource rise, the incentive to build up or "invest" in the resource will likewise increase.[13] If the resource is due to be rebuilt and the high-cost exploitation option is chosen, the period of reduced harvests will be longer and the long term sustained yield may be lower.

Whether it will be appropriate for the coastal state to consider inviting distant-water fleets to participate in its fisheries will depend quite simply upon whether distant-water nations possess a comparative advantage vis-à-vis the coastal state in fisheries exploitation. If such a comparative advantage exists, then the appropriate form of distant-water nation participation will depend upon how that comparative advantage manifests itself.

Some of the factors that may influence the distant-water nation's comparative advantage are common to international trade. Others, however, are peculiar to the fisheries.

Relative factor proportions can help to explain the advantage for distant-water nations, in some instances, particularly if one broadens one's definition of capital to include fishermen's skills and technology. Some fishery activities are labour intensive. Hence one would not be surprised to find that Eastern bloc countries, along with South Korea and Taiwan, have a comparative advantage vis-à-vis North America in some aspects of fisheries exploitation.

On the other hand, in the great tuna fisheries of the South Pacific, the coastal island states are markedly capital poor, both in terms of capital in the conventional form and in terms of fishermen's skill and technology. This provides Japan and the United States, the distant-water nations, with a strong comparative advantage, certainly in harvesting, and to a lesser degree in processing. In the large Alaskan groundfisheries, Japan's comparative advantage can be explained in part by the relative abundance of Japanese "technological" capital.[14]

Those factors giving rise to distant-water nation's comparative advantage that are peculiar to the nature of the fisheries themselves are many and varied. A few will be presented as examples.

The first such factor peculiar to fisheries arises from the common property nature of the resource. As mentioned earlier, even if the authorities take effective measures to prevent the resource from being subject to what they deem to be excessive depletion, the common property nature of the fishery will manifest itself through over-capitalization. There have been attempts to deal with this problem, in the harvesting sector at least, by imposing limits on the number of vessels and fishermen that can participate in the fishery. Programs of limited entry have often proved to be only partially successful at best because fishermen find innumerable ways of making the limited number of vessels more effective as harvesting units.

It has been argued that introducing a system of taxes or fees on fishermen would prove to be much more effective in curbing overcapitalization.[15] While this may be true, it has proven to be extremely difficult politically to impose such taxes on domestic fishermen.[16]

It is, however, politically feasible to impose taxes and fees on foreign fleet owners. Indeed this is seen as a potentially important and perfectly legitimate means of extracting a return from the foreign fleets in a coastal state's EEZ. Hence if a fishery has not already been developed by domestic fleets, the coastal state's return from the resource might well be maximized by permitting controllable foreign fleets to exploit the resource, even though on a per vessel basis their costs are no lower than those of domestic fleets.[17]

A second example of factors peculiar to this resource relates to the fact that many fisheries are highly seasonal in nature and the capital embodied in the relevant coastal state vessels is therefore not "malleable" because the vessels are specialized in nature. Vessels confined to coastal state waters can be idle in offseason. Distant-water nation vessels, on the other hand, avoid this problem because they can be sent to other fisheries in the world once the season is over. The consequence of escaping offseason idleness is that, all other things being equal, the harvesting costs of the distant-water fleet will be lower than those of the coastal state fleet.[18]

As a final example, we recall the fact that fisheries are often subject to substantial and unpredictable fluctuations. It can be demonstrated and indeed should be obvious that coastal state fleet owners will rarely wish to build fleets that are capable of taking the maximum harvests.[19] Thus a coastal state might call upon the services of distant-water fleets during periods of abnormally large harvest opportunities, even though distant-water harvesting costs may exceed those of domestic fleets.[20]

The arguments against the importation of services from distant-water nations are, as stated earlier, largely arguments for the protection of the domestic industry. Let us concede, however, that arguments for the restriction of distant-water nation activity do exist even for the vigorously pro-free-trade coastal state. Most arguments rest upon the fact that prior to EFJ, many of the fisheries subsequently acquired by the coastal state were subject to ineffective management. We consider two examples.

Let us assume that in a particular fishery the domestic and distant-water nations' harvesting/processing costs are approximately equal and the resource has been excessively depleted due to previous mismanagement. While the resource now under coastal state management is being rebuilt, fishing activity will have to be restricted. This will very likely be disruptive to the fishermen and processors. In these circumstances, the coastal state, following its own interests, will wish to minimize the disruptions to its domestic industry and hence focus most of the restriction upon the distant-water fleets.

Once the resource has been rebuilt to the desired level, the restrictions on fishing activity will be relaxed. It can be shown, however, that once OSY is reached, the minimum level of fishing activity required to take the harvest will almost certainly be less than the previous level of fishing activity, when the resource was subject to international control and was in an over-exploited state.[21] Hence one could expect that the level of foreign fishing activity would never be restored.

The second example rests on the fact that some fisheries are exploited on an inshore-offshore basis. In such a fishery, the inshore segment would almost by definition be entirely dominated by the coastal state before, as well as after, EFJ. Prior to EFJ, the division between offshore and inshore harvesting may, from the point of view of the long-term interests of the coastal state, have been unduly weighted in favour of the offshore. Thus after EFJ, the coastal state authorities will work towards a reduction of the offshore share of the harvest. If the distant-water fleets were engaged in the offshore harvest, then they must be adversely affected by the re-allocation of the harvests.

A Canadian example for which both arguments apply, at least to a limited degree, is the northern cod fishery off Canada's Atlantic coast. This was the most important fishery resource acquired by

Canada in this region as a consequence of EFJ and consists of a complex of cod stocks extending from southern Labrador to south eastern Newfoundland. The resource is exploited on an inshore-offshore basis. Canadian authorities have insisted that while the resource was under international supervision, the harvesting was biased in favour of the offshore and that the resource itself was over-exploited.[22]

We turn now to the protectionist arguments for restricting distant-water nation activity. The nature of the trade setting is not, in the first instance, one in which existing domestic industries are threatened by foreign competition. Rather it is a situation in which coastal states have acquired additional fishery resources which their fleets and foreign fleets had been exploiting in the past. The question is whether the foreign activity should continue or whether foreign activity should be replaced in all or in part by domestic entities. The replacement program being considered is comparable to the major import substitution programs encountered in developing countries. The arguments for protection that command the greatest attention, therefore, are variants of the infant industry argument.

Although this author has yet to find sources in which the argument is developed in full, the infant industry argument as it applies to coastal state fisheries could reasonably be formulated as follows. Prior to EFJ, major international fisheries now encompassed by the coastal state's EEZ may have been of little or no interest to the coastal state fishing industry and thus were left to be exploited by distant-water nation fleets. The fisheries may have required specialized vessels and/or equipment, and as an international fishery, may have been subject to inadequate management. Hence the risk of investing in the vessels and equipment would have seemed prohibitively high to the domestic industry. Distant-water fleets, which are geared to move throughout the world, would be subject to much less risk. Indeed the distant-water fleets may have engaged in what was believed to have been a common practice--pulse fishing.[23] This pulse fishing involves exploiting a fishery resource heavily and then abandoning it, perhaps for several years, until it has recovered.

Now that the fisheries are under coastal state management, the infant argument continues, they appear to be far less risky to the domestic industry. Fishermen and companies would be prepared to undertake the necessary investment, if it were not for the fact that they cannot compete with the well-established distant-water fleets. If the coastal fishermen and companies were protected until they had passed through the necessary learning and development phase, then ultimately the coastal state comparative advantage, now latent, would be revealed.

A complementary argument, which also has some limited validity, is that current distant-water fleet costs are abnormally low, a fact which serves only to disguise further the latent coastal state comparative advantage. As a consequence of EFJ, many distant-water nations now have excess fleet capacity. As we shall argue at a later point in the paper, the current relevant costs of the distant-water fleet operators are largely restricted to operating costs.

The coastal state fisheries' argument goes on to point out that the domestic industry requires protection during this period of cost abnormality. Without such protection, the domestic industry would be reluctant to undertake the necessary investment and thus would not be in a position to exploit the opportunities available to it once the period of abnormality is over.

While it is possible that foreign participation might be banned during the period of protection, this will not necessarily be the case. Distant-water fleets could be encouraged to enter into temporary joint ventures, which could then be exploited by the domestic industry as a means of acquiring technology and skills.

The criticisms of the infant industry argument in this setting are the same as those leveled at its use in other circumstances. It is difficult to determine a priori which "infants" are in fact likely to achieve maturity. Even when one can be certain that the infant will achieve maturity, one has to weigh the future benefits of developing the latent comparative advantage against the temporary costs of protection. There is no assurance that the future benefits will offset the temporary costs.[24]

One should also observe in passing that the application of the infant industry argument to fisheries carries with it the threat of conflict within the domestic industry. There are really two domestic "infants"--harvesters and processors--whose interests are by no means complementary. The "infant" harvesting sector may believe that its growth would be maximized by entering into long-term, if not permanent, joint ventures in which domestic harvesters deliver catches to distant-water vessels. Similarly, the "infant" processing sector"s interests may also be best served by entering into joint-venture activities involving distant-water vessels as harvesters. Thus efforts to protect one sector of the domestic industry might in part succeed only at the expense of the other sector.

The infant industry argument for protection, while dominant, is supplemented by others, many of which are generally well-known from the literature on international trade. Among the more familiar arguments are the cheap labour (or cheap technology) argument, the employment argument, and the balance-of-payments argument.[25] As we shall see later, the employment argument is of particular importance to Canada.

An argument that is less familiar, but which appears to be distantly related to the famous defence argument, is that which might be termed the "exploitation by foreigners" argument. This argument states that if unhindered trade is permitted, the country in question will become dependent upon foreign suppliers of particular goods and services who, in the OPEC manner, will then band together to exploit the country. Thus in a fisheries context, to enter into co-operative fisheries arrangements is to risk putting oneself at the mercy of the distant-water nations.

The Economics of Co-operative Fisheries Arrangements: The Distant Water Nation Perspective

To this point we have discussed the economics of co-operative fisheries arrangements only from the perspective of the coastal states. Even if we were concerned solely with the benefits that coastal states could hope to derive from the arrangements, it would be necessary to consider the economics of the arrangements from the perspective of the "exporting" countries for at least two closely related reasons: First, without such knowledge it is difficult to gauge the impact and effectiveness of protective measures introduced by the coastal state. Second, an understanding of the aforementioned economics is essential in order to determine the set of conditions that will have to prevail if the co-operative arrangements are to be anything other than temporary. We shall argue that it is quite possible for free-trade-oriented coastal states to become inadvertent protectionists, given the newness of the EFJ regime. That is to say, these coastal states may introduce measures that appear innocuous, but which will in fact undermine the long-term viability of their co-operative fisheries arrangements.

In order to understand the economics of co-operative fisheries arrangements from the distant-water nation perspective, it is first necessary to have an overview of the economics of distant-water fishing operations.

Distant-water fleet owners, whether private or state, have no explicit control over the resources they exploit. Consequently, in discussing the economics of these operations, one must do so in terms of the returns from harvesting/processing as opposed to the returns from resources that are being exploited. Most distant-water operations are capital intensive, hence it is reasonable to let the return on the capital invested in the vessels and gear serve as a focus for the discussion.[26]

Earlier we made reference to the "malleability" of capital embodied in fleet capacity or, to express it another way,. the flexibility of such capital in terms of modes of employment. The point was made that one possible factor giving rise to distant-water nation comparative advantage was the apparent "malleability" of its fleet capital in comparison with that of the coastal state where seasonal fisheries were concerned. One might infer from this that a prime characteristic of distant-water fleets is the high degree of malleability of capital embodied in them. This, however, is simply not the case and the appealing, but incorrect inference proves to be an example of the fallacy of composition. Indeed, the problem of "malleability" of capital is central to the economics of distant-water fishing operations.

In the short run, the degree of malleability of capital for distant-water fleets is surprisingly low. Within a given year a fleet owner or manager will tend to be constrained, often severely, by a previously determined plan that may involve not one, but several fleets plus accompanying support vessels. Thus, the collapse of an anticipated harvest opportunity may lead to idle vessels in the fleet plus disruptions of other segments of the plan.[27]

Obviously, if there is a longer lead time in planning, there will be fewer problems of non-malleability of capital. Thus, if a harvest opportunity anticipated for next year's operations was to collapse, this could cause difficulties, but not as great as if the collapse had pertained to the current year's operations.

Prior to the implementation of EFJ, the distant-water fleet owner/manager faced uncertainties arising from environmental fluctuations in stocks and the unpredictable impacts of competing fleets, both coastal and distant-water, upon the relevant stocks. In addition, to the extent that their fleets were operating in fisheries subject to the management of international bodies, there would be further uncertainty arising from changes in regulations laid down by these bodies. It must also be said, however, that regulatory regimes of such international bodies were usually notable only for their weakness.

What the distant-water fleets had, and what they conspicuously lacked after the implementation of EFJ, is broad freedom of access. This meant that each year the fleet owner/managers were presented with an extensive portfolio of harvest opportunities. Hence over the medium to long term, there was little risk that the fleets would be under-utilized. Within a single year unpleasant surprises could cause difficulties, especially in light of the flexibility of the current annual plan. However, the existence of alternative exploitation opportunities would allow at least some freedom to adjust.

With the advent of EFJ, most major fisheries are under coastal state control. As a consequence, the portfolio of harvest opportunities available to the typical distant-water nation has altered radically.

With respect to long-term planning, there is little or no certainty of access to most major fisheries in the future. Indeed some fisheries to which the distant-water nations had access in the past must now be deemed closed. Consequently, it can be argued that the range of harvest opportunities for long-term planning has been significantly narrowed and that the degree of risk associated with individual opportunities has increased.

With respect to short-term or annual plans, the consequences of EFJ are several. First it may not be possible to obtain a sufficient number of harvest opportunities to keep the relevant fleets fully employed over the year. Second, with regards to any given harvest opportunity within a coastal state zone, the degree of uncertainty or risk has almost certainly increased. In addition to environmental fluctuations, there are, from the distant-water nation perspective, the vagaries of coastal state policy with which to contend. The one offsetting positive benefit is that uncertainties arising from the exploitation of rival distant-water fleets have been reduced.

Third, the consequence of collapsed harvest opportunities within the current year are made more severe. Obtaining access to alternative fisheries in coastal state zones will almost certainly require prior negotiations. It is doubtful that there would be sufficient time to negotiate new access privileges within the confines of a single fishing year.

The reduced attractiveness to distant-water nations of operating in fisheries now controlled by coastal states is overwhelmed at present by the global, albeit short-term, impact of EFJ. As a consequence of the rapid implementation of EFJ and the accompanying restrictions on harvest opportunities for distant-water fleets, the distant-water nations were and are. as indicated earlier, faced with substantial excess capacity.[28] This, of course, is a reflection of the non-malleability of capital embodied in their fleets.

Apart from the very limited fisheries remaining on the high seas, the fleet owner/managers had, and do have, few alternatives other than scrapping the vessels when it comes to employing their fleets in newly established EEZs. Consequently, the economics of co-operative fisheries arrangements from the perspective of the distant-water fleet owners are such that they would be acceptable so long as the fleet's operating costs were covered on a year-by-year basis. The bulk of their capital costs were and are irrelevant for planning purposes, which is the same thing as saying that the fleet owners were and are prepared to accept a substantial negative return on their capital.[29]

This, however, is obviously a transitory phenomenon. Over time, the existing vessels will come to the end of their economic lives. When the fleet owners, whether private or state, come to contemplate fleet replacement, then all costs, capital as well as operating, will be relevant. Obviously, reinvestment will take place only if the expected return on capital is positive and is comparable to what could be earned on the capital if invested elsewhere.

The economics of co-operative fisheries arrangements from the distant-water nation perspective become more complex as a result. The terms and conditions accompanying the co-operative arrangements will take on substantial economic significance. The expected return on distant-water fleet capital and the degree of risk associated with that capital will be influenced by whether the agreements protect the distant-water fleet owners from capricious reductions in their activities during any given year and whether the agreements provide the distant-water fleets with continuity over time.

If these conditions are not met, then the expected return on the capital will be reduced and the degree of risk increased. If the investors in fleet capacity are adverse to taking risks, which seems to be true of most investors, then one can anticipate that, in the private sector at least, the investors will demand what amounts to a risk premium. The combination of these could lead the fleet owners to forego the investment entirely or at least to reduce it in scope, a point to which we return in the next section. In other words, the willingness of distant-water nations to participate in the fisheries of given coastal states over the long run would be reduced.

Methods and Techniques of Protection

There are many techniques by which coastal states can protect their domestic harvesters and processors, while still abiding by the terms of the Law of the Sea Convention.

It was observed in our discussion of fisheries management issues that government intervention in the fisheries is extensive, which is due to the common property problem characteristic of this resource. The intervention extends to the international sphere as well. A distant-water nation seeking access to a coastal state zone will gain such access only upon receiving the express approval of the coastal state authorities and only upon agreeing to abide by such terms and conditions that these authorities choose to impose. In the case of Canada the approval of the federal government is required. Thus coastal state authorities are in effect acting as quasi-monopolistic buyers of distant-water nation services.

The traditional textbook theories of protection--whereby competitive foreign exporters trade into competitive domestic markets with the tariff as the chief instrument of protection--would therefore not apply. To the extent that they are used at all, tariffs are enforced by coastal states on a strictly ancillary basis:[30] it is through the setting of terms and conditions of access that protection is exercised. The analogy in commodity trading is the use of import quotas together with discriminatory administrative rules and regulations.

The authorities can for example establish a total allowable catch such that the "surplus" is zero. Furthermore, they can refuse to sanction those joint-venture arrangements where domestic vessels deliver harvested fish to foreign processing vessels. Coastal states would in this way give absolute protection to harvesters and processors in a particular fishery.

If the coastal state authorities wish to discourage distant-water activity, but find it politically difficult to declare zero surpluses, they can set access conditions that will repel would-be applicants. They could, for example, set fees at a level that would make such a venture unprofitable for distant-water fleets.

It is true that the Law of the Sea Convention stipulates that coastal states are not to establish terms and conditions that will bar distant-water fleets from the surpluses.[31] With reasonable imagination, however, coastal state authorities can introduce conditions that are not blatently designed to repel distant-water nations, but which discourage them nonetheless. One such example is the case of the large Alaskan groundfisheries which constitute the single most important American acquisition under EFJ and serve as the most important basis for American co-operative fisheries arrangements.[32]

The groundfish in these fisheries are harvested with trawl nets, which inevitably capture species other than those targeted. It would appear that foreign trawlers regularly capture high-value species such as salmon and crab, which are reserved for American fishermen. In response to this concern, the American authorities have introduced so called Prohibited Species Catch (PSC) targets to apply to distant-water nation fishermen--but not to domestic groundfish fishermen. PSC targets are broken down by species, area, and distant-water nation. Once a distant-water nation reaches one of the PSC targets in a given area, it would be barred from the area for the remainder of the season, regardless of whether it had taken its groundfish allocation.[33]

Obviously if the PSC targets were set low enough, they would effectively discourage distant-water nation harvesting of Alaskan groundfish. Moreover, such regulations, would be seemingly reasonable as they are ostensibly designed to conserve high-valued species. It would be difficult for any distant-water nation to argue that such terms and conditions contravene the convention.

Coastal state authorities can, with reasonable imagination and ingenuity, use their powers to set access terms and conditions that will curb the distant-water nation interest in the coastal state's fisheries; they will in this way provide the domestic industry with very effective protection. It is also true, however, that coastal authorities seeking ongoing distant-water nation presence can, through lack of foresight in setting the aforementioned conditions, become inadvertent protectionists. The following two examples illustrate this.

Our discussion of the economics of distant-water fleet operations has so far emphasized the difference between the current position of distant-water fleet owners--they have excess capacity--and their future position, when their fleets are due for replacement. If the coastal state authorities impose ongoing terms and conditions that offer no security of harvesting/processing opportunities on an intra- or inter-year basis, then the willingness of the distant-water nation partners to participate in the coastal fisheries will wane over time.

A second, and closely related, example arises from the fact that coastal states may impose conditions that they cannot in fact enforce effectively. If this is done, then the coastal state's regime will lack credibility. One can anticipate recriminations between coastal state and distant-water nation partners and an ultimate breakdown in the arrangement. For example, if the distant-water fleet was engaging in "fee" fishing and the coastal state were to impose a tax on the gross value of the catch, distant-water vessels would have to report their catch accurately by volume and by species. If the coastal state does not have the capacity to enforce these demanding conditions, then the arrangement will become unstable and will eventually break down.[34]

Canadian Policies Towards Co-operative Fisheries Arrangements: An Overview

Passing references have been made to Canadian co-operative fisheries arrangements. It would be useful therefore to present an overview of Canadian policies towards such an arrangement.

There exists at the present time no fixed Canadian government policy towards co-operative fisheries arrangements. Since EFJ has been almost revolutionary in scope, Canadian policy on the arrangements, as with Canadian policy on other aspects of EFJ, has had to evolve as the authorities adjusted to the new regime.

If one were to attempt to describe this evolution, one might describe it as a reluctant retreat from marine autarky. In this respect it bears a marked resemblance to the evolution of the policy of the United States, even though the two countries took quite different approaches when EFJ was implemented in 1977.[35]

When Canada was looking forward to EFJ in 1974, the then federal Minister of the Environment (Fisheries), Jack Davis, stated that:

> The long-term is for Canadians. Canada is not only going to reach out and encompass all of the living resources of her continental shelf and slope, we are going to make sure that they are harvested by Canadians, in Canadian-owned vessels, and processed in Canada as well.[36]

Canada could not achieve autarky immediately, of course. In the years immediately following EFJ, Canada would have found it to be politically difficult, if not impossible, to set extremely low TACs on stocks that her fishermen were as yet unprepared to harvest. On the Atlantic coast there was also the awkward problem that the EEZ was incomplete from Canada's point of view. Two segments of the Grand Bank lay outside the EEZ and this made some stocks that were of interest to the Canadian industry transboundary in nature.[37] This gave distant-water nations bargaining power which they did not hesitate to exploit.[38]

Consequently, co-operative fisheries arrangements had to be tolerated. It was hoped, however, that the co-operative fisheries arrangements would be a temporary phenomenon and that "Canadianization" of the fisheries--on both coasts--would proceed unabated.

The reasons for this rather extreme position on the part of the government--the belief that the infant industry argument was applicable to all fisheries not then exploited by the Canadian industry--are not entirely clear. Several, however, suggest themselves.

First the largest resource gains that Canada would come to enjoy as a consequence of EFJ were clearly to be found in the Atlantic region, particularly in the waters off Newfoundland and Labrador. Canada's gains off the Pacific Coast were minor by comparison.[39] The distribution of resource gains was, in turn, negatively correlated with unemployment in Canada's coastal regions. Unemployment in Atlantic Canada in general was and is chronic and serious, while unemployment in Newfoundland has tended to be worse than in any other part of Canada. Thus with respect to Atlantic Coast fisheries at least, the infant industry argument for protection was and is powerfully buttressed by the employment argument. The Task Force on Atlantic Fisheries (the Kirby Task Force) expresses vigorous opposition to co-operative fisheries arrangements and in so doing relies heavily on the employment argument.[40]

Powerful though it may be when considering the Atlantic coast, this cannot be the only reason. The government's policy on the Pacific Coast is really no less protectionist. Here the employment argument has little or no validity.[41]

The second reason arises from the common property nature of the fishery. As a consequence of this aspect of the fishery, redundancy of capital both ashore and afloat tends to be ubiquitous. Furthermore, the industry tends to be no more than fitfully prosperous.[42] Hence when additional fishery resources are acquired, there comes into play what one might call an employment of capital argument for protection. One can observe in passing that, unless the common property problem is alleviated, reserving newly acquired harvesting and processing opportunities for the domestic industry will serve as no more than a temporary palliative.

A third possible reason for the autarkic position is the fact that the authorities, like their counterparts in the United States, were and are slow to recognize the benefits that can be obtained from permitting ongoing foreign harvesting. This is most apparent in "fee" fishing, where the foreign fleets both harvest and process the resource. The net return from the resource manifests itself in the first instance in the form of profits to foreign fleets. The coastal state and distant-water nations in theory share the return. The most direct and obvious way for the coastal state to acquire a share is through the imposition of fees and taxes. US economists[43] have criticized the US authorities for underutilizing fees, claiming that such fees that have been levied have been only for the purpose of defraying part of the US surveillance and enforcement costs. The authorities have relied on more indirect and much more uncertain forms of renumeration such as increased access to markets.

Precisely the same criticism can be made of Canadian authorities. No serious thought has been given to using taxes and fees other than to defray management costs. Such "commensurate benefits" are obtained by authorities largely through improved market access.[44] The consequences are obvious. Foreign "fee" fishing appears to offer few, if any, benefits to Canada, with the result that protectionist forces are strengthened.

To the extent that a retreat from autarky has occurred in Canada, it has been largely for the same reasons as in the United States.[45] The economic case against rapid and complete "Canadianization" of the newly-acquired fisheries has been overwhelming. The extent and form of the retreat, however, has differed on the two coasts.

On the Pacific Coast, there remains but one fishery that serves as a serious basis for a co-operative fisheries arrangement. This is a hake fishery that is shared with the United States. The government policy with respect to this fishery carries with it some of the flavour of the original autarkic approach. In allocating the segments of the total allowable catch, first preference is to be given to wholly domestic operations (harvesting and processing), second preference to joint-venture type operations, and last preference to what is referred to in Canada as "national" allocations such as "fee" fishing.[46]

Prior to EFJ, the domestic industry took no interest in the hake fishery. Hake deteriorates rapidly upon capture and so must either be processed at sea or transported in frozen form to onshore plants. Furthermore, the season is short, generally lasting no more than four months. The vessels required to prosecute the fishery were expensive and there appeared to be little opportunity to use them off season. After EFJ, a British Columbia group did purchase a vessel from the Japanese with freezing and processing capacity for use in the fishery. Since the Japanese had substantial excess capacity, the price was low. Nonetheless, the experiment has not been a financial success.[47]

Since 1978, a successful joint-venture type operation has developed, in which Canadian vessels, without freezing capacity and having off-season harvesting opportunities, harvest the resource for delivery to foreign vessels with processing capacity. To the foreign vessels, the British Columbia hake fishery is seen as, but a small segment of their overall annual fisheries program. Thus the fishery provides a clear example of relative malleability of capital, leading to a situation of distant-water nation comparative advantage.

In the recent past something in excess of 60 per cent of the TAC is allocated for joint-venture type operations. The remainder is divided equally between a domestic reserve and "national" allocations.[48] There is little reason to suppose that the pattern of allocations will change significantly over time. No one seriously argues that domestic processors will replace distant-water ones.

On the Atlantic Coast, the situation is more complex, both because the relevant resources are much larger and because the unemployment problem is far more severe than it is in British Columbia. Foreign involvement in Canada's Atlantic EEZ is overwhelmingly in the form of "fee" fishing and is confined largely to fisheries in which the domestic industry has had little interest either as harvesters or processors; the silver hake and roundnose grenadier fisheries are two such examples.

There have been some experiments with joint-venture type activity. From time to time, there have been deliveries of Canadian-caught fish such as herring and mackerel (which foreigners are forbidden to harvest) to foreign vessels. Since domestic processors have been, and are, processing these species, the joint-venture arrangements have incurred the bitter opposition of the processing sector.[49] It is the professed policy of the government to work towards the eventual elimination of these arrangements.[50]

Joint-venture type operations of the opposite form are found mostly on the northern cod fishery. The inshore sector of the Newfoundland fishery on the east and northeast coasts is highly seasonal. Processing plants that are dependent upon these fisheries are closed for much of the year. The inshore fishing season is concentrated in late spring and summer. The offshore Northern cod fishery, on the other hand, is concentrated in the first four months of the year. It has been obvious for many years that it might be possible to bring in cod caught offshore and feed it to plants that would otherwise be shut down.[51]

Since 1979, the federal government has promoted such a program on an ad hoc basis. From 1979 to 1982 approximately 20,000 tonnes were harvested under the program.[52] With the great bulk of the fish harvested by foreign vessels.

Given the highly seasonal nature of the fishery and the conditions under which the harvests have to be undertaken, economic arguments for relying upon the foreign harvesting capacity are strong.[53] Currently, foreign vessels are prepared to land cod at prices ranging from 20-25 per cent below those demanded by domestic vessel owners.[54]

Nonetheless, the government is adamant that the so-called resource-short plant program be "Canadianized".[55] In this they are supported by the recently released Kirby Task Force report, which recommends that foreign vessels be completely phased out of the program by 1987.[56] The Task Force's argument for this policy is basically a blend of the infant industry argument and what we haved termed the "exploitation-by-foreigners" argument. By the time the Canadian fleet has expanded sufficiently to fulfill the program, it is argued, foreign and domestic harvesting costs will be equalized. Moreover, if the industry were to continue to rely on the foreign vessels, the Newfoundland resource-short plants would be at the mercy of the distant-water nations involved.[57] Both claims are bald assertions. In any event, given the very ad hoc nature of the government's program, it is quite possible that foreign harvesting capacity will be unavailable for this fishery in a decade's time.

With respect to national allocations or "fee" fishing, Canada has moved towards a steady diminution of the foreign presence in the Atlantic region. In 1974 the Canadian share of the sum of TAC (excluding reserves) for fisheries off Canada's Atlantic Coast was approximately 25 per cent. By 1982, it had increased to almost 80 per cent.[58]

These figures understate the extent of the shift, as the totals include fishing areas that remain outside of Canada's 200-mile zone. Moreover, they do not reflect the fact that what is left of foreign harvesting in Canada's zone is concentrated on low-value species, for which the interest tends to be confined to Eastern bloc countries.[59]

It is the government's hope that eventually the entire resource within the Canadian EEZ will be harvested and processed domestically.[60] In this they are once again supported by the Kirby Task Force:

> [T]he Task Force share(s) the view that fish inside the 200 mile limit are a Canadian resource that ought to be exploited wherever feasible by Canadians. Canadians ought to harvest the resource, and it ought to be processed by Canadian plant workers in Canadian-owned plants.[61]

The similarity of this statement to the 1974 ministerial statement cited earlier is striking.

Nonetheless, the goal of complete domestic exploitation of the resource appears to be receding ever farther into the future. In part, this reflects the fact that the Canadian authorities are aware of the textbook maxim that protectionist policies invite retaliation. Distant-water nations have not been particularly co-operative in managing the aforementioned Grand Bank transboundary resources.[62] They have moreover threatened and actually implemented market closures to Canadian fish products,[63] there is a certain portion of the Canadian resource that will remain of interest only to distant-water nations. Be that as it may, in light of these factors, the government's policy, on the Atlantic Coast at least, has been a reluctant retreat from autarky.

Conclusions

The recently concluded United Nations Third Conference on the Law of the Sea has produced a new set of potential trade relations for Canada and other coastal states. As a consequences of the Conference, Canada has acquired virtual ownership over large fishery resources which hitherto were international common property. One important aspect of the problem of managing these newly-acquired resources, and one which gives rise to the potential of new trade relations, is the extent to which fleets from distant-water nations should be invited to participate in the exploitation of the resources.

When Canada, or any other coastal state, invites distant-water nation fleet participation in its fisheries through a co-operative fisheries arrangement, it is, in effect, importing services from the distant-water nation. The arguments, from the coastal state's perspective, in favour of such arrangements are essentially variants on the arguments for free trade. Conversely, most arguments against such arrangements emanating from the coastal state prove upon inspection to be arguments in favour of protecting various sectors of the domestic fishing industry.

Canadian policy towards co-operative fisheries arrangements has, from the inception of EFJ, tended to be strongly protectionist. Indeed we described the evolution of the policy as a reluctant retreat from marine autarky. In part, this can be attributed to the force of the employment argument for protection in Atlantic Canada, the region most heavily influenced by EFJ, yet it can also be attributed, we have suggested, to the common property nature of fisheries, a property which has acted as a constant and ongoing bar to the effective management of fisheries.

Notes

1. We make a distinction between distant-water nation participation in coastal state fisheries as, in effect, intinerant harvesters and processors and their participation through investment in coasal state onshore processing facilities or in coastal state fleets. Thus, in co-operative fisheries arrangements as we have defined them, distant-water nations are seen as providing a flow of services as opposed to contributing to the real capital formation within the coastal state. It is true, that coastal state-distant-water nation joint ventures may involve both co-operative fisheries arrangements as we have defined them plus investment by the distant-water nation in coastal state facilities. This is particularly true in instances in which the coastal states are developing countries. It is also true that the boundary between co-operative fishery arrangements, as defined here, and distant-water nation investment in the coastal state may at times be unclear.
2. Under what circumstances, i.e., is it to the economic benefit of

the coastal state to foster such arrangements and what form should the arrangements take if they are to be of maximum economic benefit to the coastal state.

3. To give some indication of the size of fisheries it can be noted that fisheries on the Grand Banks and in immediately adjacent waters off northeastern Newfoundland and Labrador have yielded annual harvests as large as 1.6 million tonnes. (International Commission for the Northwest Atlantic Fisheries, Statistical Bulletin).
4. Ibid.
5. United Nations, "Convention on the Law of the Sea", article 56.
6. See W. Burke, "1982 Convention on the Law of the Sea Provisions and Conditions of Access to Fisheries Subject to National Jurisdiction".
7. Canada, Environment Canada, Fisheries and Marine Service, Policy for Canada's Commercial Fisheries, p. 53.
8. See G. Munro, "Fisheries, Extended Jurisdiction and the Economics of Common Property Resources".
9. Canada, Commission on Pacific Fisheries Policy, Final Report. The redundancy problem may well emerge in the processing sector as well.
10. See A. Scott and Pneher, The Public Regulation of Commercial Fisheries in Canada.
11. See C. Clark and G. Munro, "The Economics of Fishing and Modern Capital Theory: A Simplified Approach".
12. It is important that we emphasize the opportunity, cost of labour and capital. If there is extensive unemployment in the coastal state, then the true cost of labour, the opportunity cost, may be well below the private cost. When comparing exploitation options in the coastal state, opportunity costs, and not private costs, are relevant.
13. See Munro, "Fisheries".
14. Coastal states currently lacking in technological capital can, of course, acquire the capital over time. This says no more, however, than that comparative advantages/disadvantages are

not static.

15. See Munro, "Fisheries".

16. As an alternative, harvest quotas on a fisherman or company basis have been advocated. These are more palatable politically, but are applicable only among a limited number of fisheries (Munro, "Fisheries").

17. See S. Crutchfield, "Management of Foreign Fishing Rights: Theory and Policy".

18. See G. Munro, "The Economics of Co-operative Fisheries Arrangements and the Northeast Pacific".

19. See A. Charles, "Optimal Fisheries Investment".

20. Our discussion of the economics of co-operative fisheries arrangements from the perspective of distant-water nations will cast doubt on the viability of this option over the long run.

21. See C. Clark, "Towards a Predictive Model for the Economic Regulation of Fisheries".

22. See Newfoundland and Labrador, Department of Fisheries, Setting a Course: A Regional Strategy for Development of the Newfoundland Fishing Industry to 1985; and G. Munro, A Promise of Abundance: Extended Fisheries Jurisdiction and the Newfoundland Economy.

23. See C. Clark, Mathematical Bioeconomics: The Optimal Management of Renewable Resources, p. 174.

24. The complementary argument of abnormally low distant-water nation costs, it should be noted, does poorly on this score. If it can be predicted with certainty that distant-water nation costs will rise sufficiently to eliminate the distant-water nation advantage, then the domestic industry should be able to undertake the necessary investment without protection. If the domestic industry declines, then the validity of the argument is open to serious question.

25. See Munro, "Economics of Co-operative Fisheries Arrangements".

26. For private fleet owners the returns would be expressed in terms of profits. For state owners of fleets from Eastern-bloc

countries, the returns might be expressed in terms of contributions to the national plan.

27. See Munro, "Economics of Co-operative Fisheries Arrangements".

28. See V. Kaczynski, "Responses and Adjustments of Foreign Fleets to Controls Imposed by Coastal Nations".

29. There is nothing more profound in this than what one learns from the elementary theory of the firm, namely that the firms will be prepared to operate in the short run at a loss so long as they cover their operating costs.

30. Tariffs could be applied to foreign produced fish products as a device for protecting the domestic industry.

31. Burke, "1982 Convention on the Law of the Sea".

32. Munro, "Economics of Co-operative Fisheries Arrangements".

33. Ibid.

34. See L. Clark, "A Study on Fees and Other Economic Benefits from Foreign Fishing Access to the Fisheries of Exclusive Economic Zones of the States Participating in the South Pacific Forum Fisheries Agency"; G. Munro, "Foreign Access to EEZ's and the Deviation of Coastal State Benefits: Methods and Techniques"; and D. Robb, "Access Conditions and Compliance Control".

35. Munro, "Economics of Co-operative Fisheries Arrangements".

36. Cited in Tomlinson and Vertinsky, 1975, p. 2570.

37. These segments are popularly referred to as the Tail and Nose of the Bank. The Tail is of particular interest to the Canadian industry. In addition there exists a bank entirely beyond the 200-mile limit in which the Canadian industry has some interest referred to as the Flemish Cap (Munro, 1980).

38. Canada, Task Force on Atlantic Fisheries, Report.

39. G. Munro, "Canada and the fisheries Management with Extended Jurisdiction: A Preliminary View".

40. Canada, Task Force on Atlantic Fisheries, Report, p. 198ff. Whether the abolition of co-operative fisheries arrangements would in fact maximize employment in the fishing industries of

Atlantic Canada is open to serious question; Munro, Promise of Abundance.

41. We have also noted the similarity between the Canadian and US positions. The United States adopted autarkic policies towards their Alaskan fisheries. In this case the employment argument is without foundation. The additional reasons given for the attraction of marine autarky to Canada should be seen as applying to the United States as well.

42. See Canada, Commission on Pacific Fisheries Policy, 1982 for a bleak description of the potentially very prosperous British Columbia fishing industry.

43. See, for example, R. Stokes, "The New Approach to Foreign Fisheries Allocation: An Economic Appraisal" and Crutchfield, "Management".

44. Christopher Allen, International Directorate, Fisheries and Oceans Canada; and Howard Keck, Atlantic Operations Directorate, Fisheries and Oceans Canada, personal communication.

45. Munro, "Economics of Co-operative Fisheries Arrangements".

46. Barry Ackerman, Offshore Commercial Fisheries Division, Fisheries and Oceans Canada, Vancouver, personal communication.

47. Munro, "Economics of Co-operative Fisheries Arrangements".

48. Ackerman, personal communication.

49. Canada, Task Force on Atlantic Fisheries, Report, p. 204.

50. Allen and Keck, personal communication. The reader will recall our earlier comments about protection leading to inter-sectoral conflicts within the industry.

51. Munro, Promise of Abundance.

52. Canada, Task Force on Atlantic Fisheries, Report, p. 235.

53. Munro, Promise of Abundance.

54. Howard Keck, Atlantic Operations Directorate, Fisheries and Oceans Canada, personal communications.

55. Ibid.

56. Canada, Task Force on Atlantic Fisheries, p. 238.

57. Ibid., pp. 238-239.
58. Fisheries and Oceans Canada.
59. In excess of 60 per cent of the national allocations are made to Eastern bloc countries, the lion's share going to the Soviet Union. Fisheries and Oceans Canada.
60. Allen and Keck, personal communication.
61. Canada, Task Force on Atlantic Fisheries, 1982, p. 188.
62. Canada-distant-water nation co-operation is supposed to take place through a successor organization to ICNAF, the Northwest Atlantic Fisheries Organization (NAFO).
63. Canada, Task Force on Atlantic Fisheries, Report, p. 198.

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18: TRANSFER AND CONTROL OF FOREIGN TECHNOLOGIES: POLICY ANALYSIS AND A LATIN AMERICAN CASE STUDY

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TRANSFER AND CONTROL OF FOREIGN TECHNOLOGIES: POLICY ANALYSIS AND A LATIN AMERICAN CASE STUDY

Introduction

The aim of this study is to analyse a number of the issues relating to the transfer and control of technology. The research focuses primarily upon transfers of technology originating in Canada and destined for Latin American recipients. Technology transfer is an inherently complex and contentious process, in part because of the conflicting objectives of technology owners, recipient firms, and host governments. As such, it is also of interest to examine those mechanisms that have the potential for aiding reconciliation between competing objectives, and for promoting mutual interests between parties in the transfer. It is in this light that the study focuses on the potential of the joint venture; as Drucker has noted,[1] the joint venture is the most flexible instrument for making "fits out of misfits". At the same time, it is also one of the most demanding and difficult tools of diversification and development that a firm can utilize. Consequently, though this work notes the extensive use--with significant variations between countries, depending on their policy framework--of joint ventures as a strategy for technology transfer in Latin America, it also points out that the success in implementing this strategy has been mixed.

The study begins with a review of the literature concerning technology transfer before turning to an analysis of the conflicting priorities between the two central players: the multinational enterprise and the less developed country. At this point, the past experience of these protagonists with technology transfer is examined, which leads to a summary of the relevant policy responses implemented by Latin American governments. Having covered the institutional details of these responses, the generally pessimistic evaluation of their costs and benefits brings one to consider the possibilities offered by joint ventures. After suggesting several advantages of the joint-venture format, the results of extensive interviews with Canadian technology exporters, and Latin American firms and government officials are discussed, and conclusions as to the significance of joint ventures in technology transfer are drawn therefrom.

Transfer of Technology: Content and Process

Beginning then with a few definitional considerations, it should be noted that the transfer of technology involves a package which may include any or all of: information, services, documentation, hardware, production and some marketing rights (including patents and trademarks), plus associated training.[2] The core of the concept is the process of transferring, from one production entity to another, the know-how needed to utilise successfully a particular technology. Technology transfer may be product-embodied, process-embodied, or person-embodied[3] or even disembodied.[4] It may be part of a corporate process of internalization,[5] or it may be carried out at arm's length. It may be a vertically or a horizontally linked operation and it can involve either patented or unpatented information or a mix thereof:

> The transfer of technology for development is, therefore, more than the transfer of commodities or of technologies embodied in products. It is, first of all, a transfer of the processes of science and technology to enhance the developing countries' capacity to understand, adapt, create, use, manage, maintain and market their own technologies.[6]

In any technology transfer relationship, the character, nature and value of the technology transferred, and the commitment of suppliers of technology and recipients are all factors that are influenced by the type of association between the two parties. The mode of association can take many forms, from which three basic models can be derived:

- an arm's-length transaction between independent entities;
- a subsidiary association, in which the transfer is completely internal, between a parent firm and its completely controlled (and ususally owned) foreign subsidiary; and
- a joint association, where the technology passes from a transferor firm to a local firm, which is a partly owned and controlled joint venture with one or more third parties.

In general, the greater the transferor's equity involvement and, therefore, the greater the implied continuing commitment to a transfer situation, the greater is the likelihood of the effectiveness of the transfer itself and its long-term value to the recipient. Better disclosure, better governance and more effective team organization and reconfiguration all result. Here is an incentive for foreign direct investment.

There is rarely, however, a genuine philanthropy in transfers and they often involve high costs to the host or receiving country through the creation of a long-term stream of dividend payments abroad. The question of whether the benefits from the transfer exceed these costs is in many countries the subject of acrimonious debate, with the desirability of technology transfer being weighed against the associated costs of foreign direct investment. Contractor and Sagafi-Nejad, Sagasti, and Goulet have, in their commentaries and studies,[7] indicated the strong dominance of values in such arguments and the difficulties involved in attempting an objective resolution. Arm's-length transactions lack the continuous commitment of the transferor. Direct investment on the other hand appears to risk giving the transferor an undersirable degree of control from the point of view of the host. As we shall see later, a middle-ground solution, which offers mutual control without the sacrifice of commitment, may be the transfer of technology through a joint venture.

Conflicting Motivations and Attitudes: MNEs and LDC Governments

The principal transferors of technology are the large multinational enterprises (MNEs). While a significant percentage of technological innovation arises, or is attributable to smaller-sized firms in the developed nations, few of these are involved directly in international transfers. Lack of resources for effective commercialization imposes significant barriers of entry even in domestic markets, and these become almost insurmountable in an international context. As a result of these barriers and various crises, especially problems of cash flow and capital access, many smaller innovators have to sell or license their new technology to firms that have the necessary resources for domestic and international exploitation.

The assimilation of purchased technology with the output of considerable innovation-directed resources has given large corporations a lion's share of the ownership of new technology. When the ownership of rights and know-how is coupled with the production and marketing resources of MNEs, these corporations are able to achieve considerable market control. This control borders at times on monopoly, particularly at the early stages in the international product life cycle, and in the capital-intensive industries. Horst thus argues that ownership of technology coupled with size prove to be the most important determinants of foreign production, since the large firm can best finance, hedge or carry foreign risks and utilize economies of scale.[8]

In terms of the application and exploitation of innovations that are potential market dominants, however, possession is only part of the picture. Over the last decade, analysts of international production have changed their focus from advantages based on ownership of technology or other resources to the logic of their utilization. Thus, Dunning argues for the value of an "eclectic" view of how production develops:

> The eclectic approach would argue that it is not the possession of technology, per se. . .but the advantage of internalising that technology, rather than selling it. . . . It is not the orthodox type of monopoly advantages, which

> gives the enterprise an edge over its rivals. . .but the advantages which accrue through internalization.[9]

Similar or related approaches also underlie other modern theories. Magee attributes the strongest strategic motivation to an MNE's concern for appropriating the earnings of technology directly and fully.[10] They therefore protect rents from competitors by selling abroad through subsidiaries. Buckley and Casson focus upon the technology owner's efforts to maximize market efficiency and creation of rents by internalizing markets within their own global corporate organizations.[11] Teece also explains international utilization of technology in terms of the MNE's search for convenience and the efficiency created by avoidance of expensive negotiations through the use of intrafirm transfer to a foreign subsidiary which avoids the need for repeated negotiations and attenuates the hazards of opportunism.

These motives are closely linked to another which is more easily expressed by corporate decision-makers, namely that of security. In Mexico for example, Monsanto makes it a policy to keep to itself most of the more valuable technical knowledge it acquires, disseminating such knowledge only to controlled and owned subsidiaries. The company decided that it has little effective protection of proprietors' rights to its technology under Mexican patent and trademark legislation. Du Pont is even more careful in protecting its corporate knowledge from open access to Mexican legislation. Its strategy in Mexico is to seek partners as required by local foreign investment laws, but to find local interests as associates that are either non-industrial, or else are in different industries. As a result, Mexico gains to some extent from the imported capital and know-how, but receives little stimulus to its domestic technological capabilities.[12]

The quest for security and control is perhaps secondary to the dominant force which motivates MNEs--the maximization of rents from their technologies. Very rarely do MNEs look upon their activities as carrying out a mission to protect, control or even to exploit a particular technology _per se_. At the right price, the technology (like the parent firm) is probably for sale. It is the earnings that can be generated from the application and the output of the technology which are of primary concern. In a similar manner, the interest of MNEs in foreign markets is basically due to their desire to increase global sales and earnings and perhaps the belief that large market shares are a means of securing long-term profits. Any strategy that increases either margins or the volume of earnings is a logical outcome of this underlying motivation. The symptoms, of course, may vary. Margins can be raised by appropriation; they can be protected or increased by various means of internalization--which may also generate greater volumes of earnings. In terms of some of the older theories of international production and investment, earnings are augmented by foreign sales which utilize advantages in overseas markets based upon ownership of technology and resources.

A change in focus from technology to the earnings that it can produce is important for more reasons than just those of semantic purity or theoretical clarification. There is a critical difference in the orientation of some of the other parties to a technological-transfer transaction. Host governments of recipient countries, for example, are also interested in what is to them the cost of a transfer. If, however, they are logically consistent with what are often stated to be their long-term goals for developing indigenous technological capabilities, then it is the technology and its diffusion which should be critical, rather than its price. A result of this type of misdirection is that the underlying motivations of MNEs and recipient governments are really focused upon different phenomena.

Official statements regarding development strategies by governments of developing nations imply that they are intended to create indigenous self-reliant capabilities for growth and improved standards of living for the citizens. Independence of decision and choice are important objectives and developing nations are therefore concerned with the potential benefits of moving the source of the technology under domestic control, permitting adaptation and generation of future technologies which meet the particular needs of the country. The perceived role of a technology in the development process affects the intensity with which countries attempt to control its transfer and the specific objectives technology policy attempts to achieve. Policy objectives in Latin American countries vary in the different dimensions they emphasize. These include benefits from enhanced local employment, use of local materials and technical inputs, the development of local technological capacity, and costs, among others.

Policy conflicts arise not only because of differing values between technology owners and recipient governments, but also from the use of different data bases and information about the consequences of technology transfers. Unfortunately, most data bases are inadequate and their data often conflict. Thus trade-offs which are made cannot be inferred from behaviour. The faulty data leads to the employment of strategies and counter strategies, which remove the parties from the Pareto possibility curve. Objective information about technical relations and desirable trade-offs could serve to make the transfer process more effective.[13]

If technology owners and recipient governments are fighting different battles and are unaware of the implicit coefficients of trade-off matrices affecting these battles, it is useful to focus upon possible areas of convergence between them. More specifically, it is useful to look at some of the policies and mechanisms which have potential for aiding reconciliation between conflicting objectives. Since ownership of resources, accrual of costs, generation of earnings and the creation of capabilities are all themes of common interest, though from different perspectives, a vehicle which potentially stresses the mutuality of interests in these themes is a necessary requirement. Whatever the problems that can arise in a specific situation, joint ventures offer, in principle, a vehicle with exactly this potential.

The Benefits and Costs of Technology Importation: Past Experience

In spite of its perceived attractiveness as an engine for stimulating growth, there is little evidence that technology has solved many of the development problems of Third World countries. This is partly due to limitations in transmission on the part of the owners of technology. It is also due to the inadequacy of institutions and the lack of sound integrated approaches to the creation of suitable policies at both national and international levels. A further barrier has been the inconsistencies in approaching the achievement of a suitable balance between imported technology and the development of national capabilities. As a result, many developing economies have become dependent upon imported technology. Even in a relatively advanced, newly industrialized country (NIC) such as Brazil, Packenham has estimated that 97 per cent of the country's production capacity in industrial sectors depends upon foreign technology.[14] This level of reliance is likely to impose net costs. Patel for example calculates that total costs, direct royalties and fees, plus indirect costs, which are up to ten times greater in volume (including overpricing of intermediates and transfer pricing), come to as much as $50 billion per year.[15] At the same time, investment by less-developed countries (LDCs) in indigenous research and development (R&D) was only $2 billion, perhaps 5 per cent of the cost of technology imports.

Unfortunately, the political reaction to these estimates was to deny the benefits of technology rather than to seek new means of exploiting it for the benefit of the country. It has led to such unconstructive comments as the following:

> Technology is the new variable which restricts and limits countries' freedom of action and, above all, of decision. It is rightly claimed that, at present, the U.K. has its former colonies on a tighter rein than before, despite the fact that it has granted them political independence.[16]

To grow in technical capability, a country needs an adequate scientific and technological infrastructure. The lack of such a base will result in the decay of the imported technology. Furthermore, imported technology may prevent the creation of indigenous technologies. Development of a genuine, national scientific and technological capability, however, is a long process and the "trickle down" strategy, where it was attempted, has been inadequate. Significant pay-offs--from providing assistance to the local infrastructure by helping universities, technical institutes or schools, to training students abroad--took too long and were politically unpalatable. They also tended to reinforce the dualism between the modern and traditional sectors of some of these societies, encouraged economic and social divisions, initiated "brain drains", and led to insufficiently critical acceptance of the foreign technical and social norms associated with technology transfers.

Maximo Halty-Carrere has blamed the lack of effective technological development (TD) upon poor policy-making in Latin America: too much concern for methodological guidelines, too much reliance on technocratic approaches, too many detailed studies of the scientific and technical inventories, too little identification of major options and generation of integrated policy measures. He observes:

> We either depended on dogmas or reacted to events. In one case we accepted the "scientific" approach: promote research and development (R&D) and the economy will sooner or later absorb it. The problem was that it did not. And in an LDC environment it does not. To put emphasis on building up a research system that was completely separated from the decision-making process and the economic life of the country was no solution at all.[17]

To create an adequate, indigenous technological and scientific capacity requires direct technical co-operation as part of the transfer of technology itself. Not only does this improve the probabilities for the successful grafting of the specific technology involved, it also has a more powerful impact in providing a broader context of national capabilities. It is this focusing of technology in practical applications which makes the transfer process a potentially more powerful learning mechanism in LDCs than less applied modes of development.

If it can be properly evoked, there is a valuable and potentially mutually reinforcing feature to this aspect of technology transfer. Availability of a good technical and scientific infrastructure can be a strong attraction for MNEs seeking a suitable location for their own foreign R&D activities. Unfortunately, this creates a vicious cycle, as one of the reasons for soliciting a foreign firm's R&D operations is the desire to strengthen the scientific and technical capabilities in the country. As Behrman and Fischer point out, however, in cases where some countries have been able to attract R&D location by MNEs, the key has been a desirable market, not host government incentives. Furthermore, it has been the developed countries that have tried to make their potential as R&D sites more attractive, while LDCs have typically resorted to negative inducements and hence to perpetuating the vicious cycle.[18]

In view of the historical evidence that they have paid excessive prices for transferred technology in the past, many Latin American governments argue that all prices incorporate excess rents well above the actual cost plus reasonable amortization of the R&D involved. Further, they argue that most corporate R&D is oriented towards the home market in developed countries and is initially fully amortized on the basis of sales in those markets. Thus, the marginal cost of reproducing the technology in a new market should only be a small proportion of the original cost of developing the technology--and should be priced accordingly. Interestingly, the amortization issue in price calculations may be less critical, as some LDCs are:

> themselves now purveyors of technology that they have developed. This has caused some of them to recognize that royalties must pay for unsuccessful R&D efforts in unrelated activities, that appropriation of the rewards of invention is more easily accomplished with patent coverage. . .in developing their own policies toward technology outflows, they are beginning to reassess their postures toward inflows.[19]

Host governments are also concerned with the fact that much of the past technology transferred in was suitable for a developed market, but was not appropriate for the LDC's own conditions. The arguments about appropriateness raise the issues of capital versus labour-intensive production technologies and their suitability for LDCs. Indeed, a major trade-off perceived in LDCs is a choice between long-term technical development and short-term employment objectives. In this context, Emmanuel argues, for example, against the concept of creating something called an "appropriate" or "indigenous" technology for its own sake. He suggests that technologies that are "appropriate" to the underdeveloped countries would tend to freeze or perpetuate underdevelopment. Further, he points out:

> There is some contradiction in recommending industrialization with a view to developing--and, therefore, in the final analysis with a view to increasing workers' revenue--and choosing, to bring this about, labour-intensive techniques which can only exist thanks to low wages, i.e. thanks to underdevelopment.[20]

There are many anecdotal accounts citing gross mismanagement of the transfer process in LDCs. These examples point to the incompetence in decision-making, such as sending snow parkas to Africa. These anecdotal accounts tend to ignore two facts:

- many such decisions to import are made by local firms or governments, with reasons of their own that can hardly be attributable to the owners of the technology, and
- if the decision had actually been made by the latter, then they were usually later punished through damage to their long-term earnings for the inappropriateness of their decisions, something which is part of the market-learning process.

Another source of dissension between MNE technology owners and host governments arises over the issue of "unbundling". Host governments state that the cost of imported technology incorporates both "inappropriate" elements and parts that could be obtained more cheaply elsewhere, either from alternative international suppliers, or from domestic technical synthesis. They argue therefore, that sellers should "unbundle" their technological packages to give purchasers the option of reducing effective costs and monopolistic rents.

> The packaged nature of the contribution of the MNE. . .is in this context the cause of unequal distribution of gains from trade and investment. If the package broke or leaked, some of the rents and monopoly rewards would spill over into the host country.[21]

For their part, the MNEs state that they own the technology--it is not a good to be picked over in the public domain. Furthermore, most technology developed in-house incorporates significant aspects which are part of the overall corporate facilities and capabilities--commonly described as part of the "corporate package". It is often a virtual necessity to implement transfers internally within the overall corporate group in order to be able to properly utilize these facilities. The alternative would be to replicate the firm's overall facilities. This, in fact, goes beyond a reiteration of the internalization thesis, since it also includes a reasonsable attempt at transfer efficiency. The latter is probably a more significant motivation than the more "sinister" one of trying to prevent competitive entry by licensees. Apart from some intrinsically stable fields, the rate of technological obsolescence has increased so much over the last two decades that licensee competition is not a major threat in world markets, especially those located in developed countries.

There have been a number of studies of the potential for re-structuring technology, notably by the United Nations.[22] These have furthered the discussion of issues such as restrictive practices and the accurate evaluation of costs, but have not produced completely compelling reasons for the unbundling of technology. On the other hand, studies such as those of Behrman and Wallender or Helleiner[23] have added managerial, marketing and other skills to the package of technological skills and knowledge, which together comprise the basis for efficient transfer of technology.

A final argument in this respect is that much of the discussion regarding unbundling offers another example of misplaced concreteness. The power of MNEs associated with a package of technology lies not in the package, but in the ownership or control of key technical, or other, components. Unbundling will not, therefore, reduce the price of the package, since the owner can increase the monopolistic rents charged on the key components in order to re-establish its required return on the technology. Basically, it is more sensible to consider the disputes regarding unbundling as manifestations of the process of negotiating over the costs of the transfer.

Government Response to Technology Imports:
The Past and the Present

Having covered several of the costs of technology transfer for these developing countries, it is time to consider their policy responses. Japan provided the world with an excellent example of how technology transfer can be an important factor in economic growth. On the one hand, the success of the Japanese in importing technology at a low, long-term cost and the emergence of nationalistic political movements in many of the less-developed countries on the other hand, have led to a re-examination of technology transfer regimes.

Four major concerns have guided the development of technology transfer regulatory frameworks:

- the cost of imported technology,
- the impact that importation of technology has upon the balance of payments,
- the restrictions imposed on the use of imported technology and their threats to economic and political sovereignty and security, and
- the adverse impact that importation of technology may have upon the growth of domestic, technological capabilities.

The rationale for regulation has been based on the following observations:

- The technology market is imperfect and asymmetries of information give suppliers great bargaining advantage, especially when dealing with private buyers in developing countries.
- Government intervention can correct for these asymmetries and force cost reduction so as to reduce the rents extracted by the supplier.[24] Furthermore, the government can forbid restrictive contracts that inhibit local competition and unreasonably protect the interest of suppliers in other markets.
- The regulation of technology imports by the government is necessary to protect the local "infant" technology industry and to help the country realize its long-term relative advantage.[25]
- The reduction of costs of imports and the restriction of technology imports may, as with other types of import barriers, help the balance-of-payments situation (at least

in the short term).[26]

Initial regulatory moves in many countries were linked to balance-of-payments considerations and, therefore, focused upon the controls of payments abroad for transferred technology. To this major thrust, concerns and controls aimed at other contractual conditions were added. In particular, buyers of technology wanted full ownership after a reasonable period. The duration of the agreement and its restriction were therefore targets for regulation. Another important aspect was the imposition of restrictions associated with the use of the technology.

Attempts at the international level to formulate codes for regulating the transfer of technologies between countries have been characterized more by an emphasis on the differences in aspirations and concerns of the various stake holders, than in the development of a harmonious standardization of technology-transfer regimes. The flow of information and the discussions that were stimulated did, however, trigger many unilateral actions. The late sixties and early seventies were marked by regional attempts to co-ordinate the flows of technology and investments, but the institutional arrangements that emerged often reflected the specific economic and political environments of the participating country. Even when similar "model codes" were adopted by all members, variations in the depth and methods of implementation led to the evolution of significantly different systems of controls.

Less legitimate perhaps, but certainly less costly for many LDCs in the short term at least, is the acquisition of technology through reverse engineering and even "pirating". (Example includes Vide, the recent Russian "creation" of a new microcomputer which is merely a "reversed" Apple or the Hong Kong-built "Pineapple" of similar ancestry.) The strategy works well, however, only in relatively advanced countries (those with technically sophisticated firms) or in situations where complex components are available in open competitive markets. It does not give rise to the desired corporate technology package, however. For most LDCs, a more effective approach is probably to officially welcome the import and transfer of patented technology by providing some protection and compensation--since these are sought by MNEs--while at the same time developing a non-antagonistic regulatory machinery to ensure that their interests are protected. The problem is then, however, one of preventing "over protection" that may stifle the transfer process.

An Example of Regulatory Response: The Case of Technology Transfers in Latin America

A region that has experienced many of the aforementioned policy responses to the problems of technology transfer is Latin America. As an UNCTAD study notes, "Latin America as a region is probably the part of the Third World that exhibits the most developed experience in control over transfer of technology through contractual channels."[27] For the purposes of our study of technology transfer, we have focused on five Latin American countries: Brazil, Colombia, Mexico, Peru and Chile.

The early 1970s marked the take-off of formal regulatory systems to control transfers of technology in all these countries. Decison 24 of the Acuerdo de Cartagena, adopted by the Andean group of countries, was incorporated into the national law of the member states in 1971. Colombia formally incorporated Decision 24 into its national law in 1973 after the Supreme Court found a 1971 decree to be unconstitutional. Mexico enacted its own law to control the transfer of technology in 1972 and created the Registro Nacional de Transferencia de Technologia. In Brazil, even before the formal adoption of the industrial property code of 1971, the National Institute of Industrial Property (INPI) was established in 1970, consolidating all previous attempts to control technology transfers. Significant changes in the regulatory framework occurred in Brazil, with the enactment of Normative Act 015 in 1975 (INPI), and in Chile, where the transfer-control regime, initiated to conform with Decision 24, was dropped when Chile withdrew from the Andean group in 1976.

In practice, the actual process of the regulation of technology transfers includes a registration procedure and the follow-up. The registration process includes the evaluation, authorization, and registration of a technology. These stages have been implemented in various ways in the countries we are considering. In Brazil, the registration process is the responsibility of INPI, while the Central Bank, in its duty to control and register foreign capital, is responsible for the follow-up supervision of remittance flows. In Colombia, the technical secretariat of the Royalties Committee in the exchange office is responsible for evaluation. The committee is in charge of authorization and the exchange office is responsible for registration. The technical secretariat is in charge of follow-up. In Mexico, all the facets of the control of technology transfers are concentrated in the offices of the Directorate General of Foreign Investments and Transfer of Technology. In Peru, the Technical Secretariat of the National Committee for Foreign Investments and Technology is in charge of all aspects of the process except the authorization, which is vested in the National Committee.

Since its withdrawal from the Andean Common Market in 1976, Chile's foreign investment and technology transfer legislation has been pared to the bone. The country's policy is based upon three "fundamental principles: equal treatment of foreign and national investors; free access to markets and economic sectors; minimum State intervention in business activities."[28]

The ruling legislation is Decreto Ley No. 600 (1977); Estatuto de la Inversion Extranjera. The law is brief and simple. It lists six ways of introducing foreign direct investment, including bringing in a technology and capitalizing it as a legitimate part of the authorized investment. All new investments and associated technology have to be authorized by the Comite de Inversion Extranjera, which is now part of the Central Bank, but reports directly to the Minister of the Economy.

The evaluation processes typically include a legal examination as to the conformity of a transfer agreement to the national law, the identification of restrictive practices, and the verification of appropriate guarantees and arrangements for settlements in case of disputes. The examination of technological aspects varies from one country to the next, but the question of availability of local technology dominates the assessment in all countries. The effective barriers imposed by this examination depend on the specific standards used to define what is "new" and what is meant by "available". UNCTAD reports, for example, that in Mexico between February 1973 and July 1975, only 0.58 per cent of the negative decisions issued by the registry included as a reason for rejection the local availability of a technology.[29] In contrast, it reports that between 1967 and 1977 in Colombia, a significant number of technological transfer agreements were rejected by the Royalties Committee on the basis that similar products were already available locally without payments of royalties (101 agreements out of 308 rejected in total) or that the technology had already been assimilated by local producers (53 agreements).

The major problem with the technological examination is usually a lack of sufficient information about technological details (which typically do not accompany the agreements) and the scarcity of technical resources to evaluate the proposals. The technical/professional capabilities available to evaluate proposals vary significantly among the different countries. In most instances, the professional personnel of those institutions that evaluate the proposals are dominated by economists. Correara reported in 1979 that in Brazil, 63 per cent of the professional staff involved in evaluation were economists, 17 per cent were engineers and the remaining 20 per cent were lawyers. In contrast, in Mexico the composition of the staff was almost evenly divided among lawyers (30 per cent), engineers (30 per cent), and the economists (40 per cent). In Peru, no engineers participated in the evaluation. In Colombia, engineers dominated the evaluation process, while lawyers provided additional screening during the registration phase.

The size of the professional staff involved is an indicator of the sophistication of, and often of the demand for, information and the length of the process involved in obtaining approval for transfer agreements. Indeed, our interviews with local business executives and local facilitators of technology transfers in Brazil indicated that, though the regulations have not been tightened, the sophistication of INPI regulators has significantly increased the costs and time delays in preparing and presenting technology-transfer proposals. This makes it very impractical for smaller and medium-sized companies to import technology through contractual transfers. On the other hand, many of the MNEs investing directly in these countries have little reason to apply for registration, since the payment of royalties from a subsidiary is treated, in most cases, as a profit remittance.

As we have indicated, concern over the price of imported technology was prominent in all the initial arguments for government control of technology imports. The determination of a fair price for technology is a complex matter. On the one hand, governments should permit the extraction of Schumpetarian rents (rents that are necessary to motivate entrepreneurs to spend on risky R&D); at the same time, they should also attempt to prohibit payments of Ricardian rents (rents that are pure or fortuitous).[30]

While the principles are clear, implementation is difficult. Only Brazil, for example, attempts to control prices charged for each type of transfer, distinguishing between the licencing of patents, the licencing of trademarks, the supply of industrial technology, the technical-industrial co-operation and specialized technical services. Within each category, price evaluations are made on the basis of comparisons with other cases on which INPI has ruled for similar transfers in that particular area of technology. No systematic methodology for evaluation appears to be employed, and consistency of decisions is achieved through the application of precedents. The range of royalty rates, however, is rather narrow, from a maximum of 5 per cent permitted for transfers of technology concerning basic industries, down to a 1 per cent maximum for the use of trademarks.

In Colombia, a distinction is made between transfers of technologies that are aimed at production for domestic consumption and those transfers that enhance exports. The former are subjected to a 5 per cent maximum, while for the latter a 7 per cent rate is permitted. In analysing the experience of several Latin American countries, an UNCTAD study concludes that:

> the process of renegotiation, based on price evaluation undertaken by competent bodies, has provided a viable method for reducing prices for technology, at least with regard to those prevailing in existing contracts or to those

> explicitly stipulated in agreements submitted to the government for approval.[31]

The experience cited by the report shows Mexico obtaining a savings of $216 million between 1973 and 1975. The reported savings in other countries were significantly smaller, but it is possible that the fact that evaluation takes place encourages compliance in preparing the agreements and that without such evaluation, the initial demands for payments for technology transfers could be significantly higher.

Two further issues of importance in the contractual aspects of technology transfer that are dealt with by regulation are the time-frame of the contracts and the removal of unreasonable restrictions imposed by the owner of the technology. In general, the regulation of time frames for contracts has proven effective. In the 1960s, the practice whereby companies insisted on indefinite terms for transfer contracts has been completely eliminated and the average duration of contracts in most Latin American countries has been reduced significantly. The shorter-term contract does not necessarily mean that contracts expire; rather, it not only permits a tighter monitoring by governments, but also allows for more flexibility in adapting contracts to changing environmental conditions. The regulation of restrictive practices, however, has been less effective. The attempt to eliminate restrictive practices focused on preventing suppliers of technology from: stifling competition and creating or maintaining a monopoly position in the domestic market, or preventing unfair competition in international markets.[32] Aguilar points out, however, that the elimination of formal clauses in contracts, especially when transfers between subsidiaries and parent companies take place, does not mean that restrictive practices are not maintained informally.[33]

The ability of MNEs to use direct investment to retain control of technologies transferred to subsidiaries prompted many countries to adopt increasingly restrictive policies, "following the Japanese mold, against equity investment, preferring licensing as the mode (of transfer) where possible."[34] Indeed, an impending general shift in the modality of international transfers toward arm's-length transfers was recognized by Baranson and others.[35] The specific restrictions associated with this trend included measures such as the prohibition of payments for technology from subsidiaries to parent companies, in Brazil and Colombia for example. Even where formal prohibitions are not enacted, such as in Mexico, applications of discretionary powers of the institutions in charge prevented the authorization of such payments.[36] While Colombia and Peru also have such legislation in place, exceptions are made for payments for "technical services", permitting greater flexibility in controls. In general, interviews with officials in charge of regulating technology in Latin American countries confirmed an increasing preoccupation with the "process of transfer". In particular, the question of what specific institutional/legal model ensures a balance between host control and flexibility and efficiency of transfer appeared paramount in almost all our interviews.

Models of Association in Transfers of Technology: Evidence and Speculation about Costs and Benefits

If the format of government policy relating to technology transfer in Latin America is now clear, its ultimate impact has not yet been determined. The paradox of foreign participation in ownership of local assets and the ambivalent attitudes of host governments towards foreign involvement in local operations have been well documented in the literature. As suggested earlier in this paper, effective transfer basically needs commitment by the transferor. The greater the commitment and participation of the technology owner in a transfer, the more effective (in most cases) is the transfer and diffusion of the technology. But full participation involves varying degrees of foreign ownership. As a rough rule, subsidiaries of foreign firms receive full internalized transfer, while licencees at arm's length receive exactly what they pay for and no more. Foreign ownership, however, creates an expensive, long-term stream of dividend servicing abroad, potential foreign control over significant domestic industrial activities and associated markets, together with other costs that are targets of host governments' intervention in LDCs.

There are dangers, however, in some of the arm's-length policy alternatives. Transferors involved in arm's-length transactions generally have a reduced commitment to and involvement in the transfer process. The result is less effective technological transfers. Little training beyond the skills directly needed for the job at hand can be expected, unless terms and conditions specifying training and the creation of local comparabilities are included in the contract. Arm's-length transactions in imperfect markets may also result in myopic market manipulation and exploitation by owners.

There is a general tendency for patent systems to stultify local technology development.[37] They also have important effects on market restrictions and volumes of output and prices, most of which work to increase market imperfections in favour of technology owners. Patent systems have been the particular targets of UNCTAD in its attempts to create new rules for the technology transfer game. Patent registration, for example, is often part of a pre-emptive strategy to keep competitors out of the patent-covered market. This strategy perpetuates the monopolistic advantages of technology owners.[38] A related feature is that patent holders also achieve some temporal control over the rate of local economic development. Once assured of their rights in the local market, the need for early actual disbursement of funds for foreign direct investment becomes much less urgent. In other words, the exclusive right granted under patent protection permits the technology owner to control a market without actual investment for a period of time.[39]

The main features of the situation have been summarized by Penrose as follows: foreign registrations of patents in LDCs are essentially control mechanisms based upon restrictive practices; they often fail to assist in local industrial development or to significantly benefit local firms or to stimulate the creation of indigenous technological capabilities.[40] These assertions have been supported by later studies. Contractor for example describes how patents in 102 licensing agreements by U.S. firms in 41 countries were rarely critical to transfer decisions themselves; and patents considerably increased the costs of associated agreements.

If arm's-length strategies are still considered to be a good bet by a host government, or if full foreign participation is calculated to be too expensive, one reasonable solution may be some form of "compulsory licensing". This has been a popular strategy in the early 1980s,[41] especially in the newly industrialized countries (NICs). There are dangers in this strategy too, however, as technology owners may counter by withholding vital know-how needed for full implementation until it is expressly paid for, thereby reducing the effectiveness of transfer.

Another model of association focuses on the potential mutuality of interests, or "jointness". Many technology transfer situations involve joint efforts of limited duration in the form of turnkey project development or consortia, established with a specific time horizon for completion and dissolution of the joint relationship. In such situations, there is limited commitment of resources, and those resources that are allocated are very rapidly amortized over the short duration of a contract. If the relationship begins to show dysfunctional stresses, at least the participants know that they are only tied in for a short time, making such stresses more tolerable. In a joint venture, resources are committed on the same indefinite basis as in most corporate investments. Objectives are longer-term and usually continue after interim completions. These features make joint ventures a much more difficult type of vehicle to run than a unilaterally owned and dominated subsidiary.

Whatever the difficulties in the operation of such ventures, there have been growing pressures from LDC host governments over the last two decades to use this particular modality of transfer. Basically, their aim has been to increase national internalization of the benefits available, as well as to augment the local share of earnings from foreign investment and associated technology imports. Searching to placate government sentiments and to prevent further pressures from a variety of nationalistic opposition groups in local political arenas, many MNEs have shifted their own investment strategies. Instead of seeking primarily full ownership as a method of direct control, they have accepted the necessity of developing joint ventures as the preferred means of transferring technology. Such moves were further encouraged by a variety of governmental schemes open to joint ventures, but excluding foreign-controlled subsidiaries, especially under ANCOM legislation.

There are seven main reasons for a foreign investor to use the joint-venture format when entering into an operation in another country. Five are essentially positive strategies on the part of the foreign investor or transferor of technology, while two are motivated primarily by host government pressures:

- risk spreading. This has two main sub-goals. The first goal is the attempt to share normal business risks. The aim is to avoid over-exposure resulting from concentration. Coupled with this conservative objective is the strategy of trying to make limited capital or other resources go further by spreading them over more opportunities. A second goal is that of trying to reduce uncertainty in a foreign environment by recruiting partners with information, and building local defences.
- complementary local resources. These may be complementary simply in the sense that the foreigner lacks certain resources that must be obtained in any case in order to set up a local operation. They could include sites, plants, equipment (rarely), skilled labour or domestic capital.
- complementary local facilities or capabilities. Included here would be influential access to local sources of power or authorities, knowledge of local customs, culture and practices, and local marketing or distributive channel controls. It would also cover the availability of local technical personnel and facilities or local competent management.
- local identity. There may be some advantages here, as such an image may generate some customer loyalties, but this is not a strong argument where local technology is underdeveloped or inefficient. The main advantages in a local identity are more likely to be in the access to local treatment of local firms with respect to taxes, quotas or

tariff protection.

- local market access. This is partly linked with identity. The objective is to overcome threshold impositions by host government custodians of attractive local markets in their efforts to create broader and more sweeping discrimination against the potential market power of MNEs. This objective of joint ventures is especially important for firms that are trying to exploit import-substituting technology geared to local markets.
- host government restrictions. In some situations, joint ventures are the only feasible (both economically and legally) means of transferring a technology, given the regulatory framework. As we indicated previously, there is a growing preference among regulators in most of the countries in our study to encourage joint ventures. The method used by governments may be explicit, or indirect, it may involve a direct ruling on a specific case by a host government agency or it may involve the use of direct suasion or of signalling through quasi-official leaks from reliable sources. Finally, it may even work still more indirectly, through a foreign investor's untested fear of potential regulation or discrimination.
- host government incentives and government spending. This type of governmental pressure is quite explicit and applies direct pressure. It is, however, a more sophisticated directional mode. In practice, the incentives are rarely high or attractive enough to induce foreign technology owners to invest solely on the basis of incentives. As a result, such incentives tend to create a bonus for those who have already converted. The increasing involvement, however, of governments in the development process and the increased consumption by the public sector of technology in certain fields (such as the military and the energy sectors) create opportunities for joint ventures. Indeed, public sector corporations and government agencies are

> often free from the constraints of many of the regulations imposed on technology transfers. This fact and the monopoly position that they hold in certain areas create opportunities for MNEs that are rarely available when dealing with the private sector.

While the above reasons suggest the use of joint ventures to be a logical choice and one that would reduce some of the costs of alternative modes of association previously noted, it remains to be seen to what extent they are operative in practice; for this it is necessary to turn to our interview material.

Joint Ventures as a Vehicle for Technology Transfer in Five Latin American Countries

The findings summarized in this section are derived from over 250 interviews, discussions, and sets of correspondence with government agencies, businessmen, and experts in the five countries studied, as well as with the executives of Canadian firms participating in joint ventures in these countries. The material focuses on several points raised in the preceding sections, notably the issues of concern to both the transferor and the recipient of foreign technology and the potential of joint ventures for alleviating some of these concerns.

Issues of Concern in International Technology Transfers

One of the primary issues of concern to Canadian partners in a technology transfer is maintaining control over corporate technology. As mentioned previously, transferors are often under pressure from host governments to "unbundle" their technology. Both transferors and potential transferors, however, wanted to avoid unbundling since this led to a loss of control over their own corporate technological packages. Many technology owners felt the issue of control was particularly vital with respect to technology transfers to Peru and Colombia. Doubt was expressed about the tolerance and reliability of the national authorities in those two countries in their treatment of foreign technology, especially insofar as Peru and Colombia could take refuge in the stringent conditions of the Agreement of Cartegena.

Some respondents, therefore, thought it was vitally important to obtain specific and firm promises of protection for each technical transfer to Colombia especially, and to Peru to a lesser extent. In some cases, the perceived "risks" of conducting business in these two countries was given as justification for the expectation of a greater potential return on investment than would be required elsewhere in Latin America.

In general, Chile, Mexico and Brazil were perceived as offering greater protection to technology transferors. The more formal, precisely defined and implemented regulation systems in Mexico and Brazil appeared to be accepted as evidence by some companies of tolerance, justice and reliability in the protection of industrial and "intellectual" property--once the latter was accepted for registration. Brazil has been particularly tolerant in the past due to confidence in its own technical ability to adapt and internalize technology. There was some concern that this attitude may change in the future because of the potential for bureaucratic interference on the part of INPI.

Chile was also perceived to be more reliable than Colombia and Peru with respect to protection of a technology transfer. This stemmed in part from the laissez-faire policies relating to foreign trade, investment, and techological transfer adopted by the Chilean government, especially since that country's withdrawal from the Andean Common Market in 1976.

A second issue of concern to technology transferors was the capability of the recipients to effectively absorb the new technology. Respondents generally expressed little confidence in the indigenous, technical, absorptive capability in Peru and Colombia, but each of the other three countries studied were perceived to have considerable competence to absorb new technology. As a potential recipient of foreign technology, Chile was perceived to be in the same category as Mexico and Brazil.

Control over inward transfers of technology was also a critical issue for recipient host governments. Mexico has been a leader in the crusade for control over international technology transfers to developing nations. As such, the Mexican authorities concerned with transfer regulations appeared to attach great importance to issues such as avoiding technical dependence, creating indigenous technical capabilities, and controlling the foreign-exchange costs of foreign direct investment. Brazilian (INPI) and Colombian (Planeacion) authorities also considered most of these issues to be important and were particularly concerned about the danger of allowing patented information to be used to manipulate markets and to increase technical and value-linked dependencia. Brazilian authorities sought diversification of technology-sourcing and the development of indigenous Brazilian technology-generating capacity as critical areas of policy. They seemed to be less concerned about the precision of appropriate technology, arguing that--as a result of their efforts and success in stimulating local technical creativity--Brazil was already capable of modifying most technology to its own particular requirements.

Colombian regulators appeared to take almost as strong a general position with respect to key issues of technology transfer. Yet Colombia's intrinsic economic strength and bargaining position are not equal to those of Mexico and Brazil. Colombian authorities expressed particular concern over the issues of technical and value-linked dependence, and the abuse of patent protected market positions. Since the 1960s, Colombia has been a leader in establishing rules to control foreign investment, a leadership that culminated in the adoption of much of Colombian legislation to structure the Cartagena Agreement. Certainly PLANEACION is a very well organised and entrenched bureaucratic machine. In view of the lack of foreign investment interest in Colombia, it may be unrealistically efficient and obdurate.

Peruvian and Chilean authorities, on the other hand, appeared less concerned with most of these controversial technology transfer issues. Technical transfer and the creation of capability and growth are clearly more important than dependence and cost or control, no matter how closely linked to general economic development the latter considerations might be. Both Chile and Peru are in a weaker bargaining position vis-à-vis foreign technology owners. They want foreign technology and associated benefits and seem less insistent upon implementing control mechanisms over technological transfers than the other countries studied.

As might be expected, the operating recipients of transferred technology expressed less concern over issues associated with technological transfer than did their national regulatory authorities. In all five countries included in the study, individuals from the private sector who were interviewed believed that the economic benefits and growth resulting from technological transfers were more critical than the merits of the technology per se. Private interests did, however, tend to be in agreement with their respective national authorities when it came to the importance of creating local technological capability in each country.

A more immediate concern expressed by individuals in the private sector was the need to generate and maintain competitive capabilities in the face of international competitors, capabilities that fall within the scope of domestic markets and local operations. For the same reasons, most private sector recipients of technology felt it was important to broaden the scope of their choice, that is, to seek to increase technical sourcing options.

Mexican recipients of technology and, to a lesser extent, those in Brazil and Colombia expressed concern over the issues relating to control and manipulation of domestic markets by foreign technology monopolists. Unlike national regulatory authorities, individuals in the private sector were not concerned with the issues of excess rents and technical dependency. As a matter of fact, most recipients are themselves monopolistic manipulators of their domestic markets. They use imported technology as the leverage for their domestic competitive advantage and the patent or other protection awarded to the technology serves to keep out non-licensed local competition, and pass on any excess prices to their customers in local markets.

Again, in contrast to national regulatory authorities, few private interests expressed much concern for the issues of controlling or of limiting the costs of foreign direct investment. In Brazil and Mexico, the level of development of the indigenous private sector is such that foreign investment no longer appears to be much of a threat (even though, for short-term lobbying needs and the considerations of special interests, the issue of foreign dominance can always be cited). In Colombia, the Acuerda Cartagena protects against foreign investment so effectively that some Colombian private sector interests have expressed doubts over its stringency. In both Chile and Peru, these doubts have already crystallized. In those countries, a number of government authorities, from the ministerial level down, as well as private interests, mentioned the need to encourage foreign investment and associated technology rather than to concentrate upon controlling them.

In fact, Peruvian and Chilean private sector recipients expressed very little concern for any of the potentially negative issues associated with technology transfer. In both countries, the problem commonly expressed was that of finding ways to attract technology transfers--in any form and whatever the price. Peru, even before the latest political upheavals, was at the very bottom of the foreign transferors' lists of markets to be considered. Chile has still not fully regained the confidence and favour of the foreign business community; it suffers from hostile international media coverage and is, in any case, an insubstantial market.

The Use of Joint Ventures for Technology Transfer

As discussed earlier in this paper, there have been growing pressures from LDC host governments during recent years to employ joint ventures as the primary mode of technology transfer. Our interviews suggest that different pressures affecting the use of joint ventures are at work in the five countries studied. In many instances, joint ventures have been seen by recipient governments as a means of addressing their concerns about inward transfers of technology, and for this reason, joint ventures often are the favoured mode of association. For transferors, however, joint ventures are often the least favoured vehicle of transfer, and the primary motivation for their use stems frequently from host government pressures.

Certain features stand out in the interview data with respect to individual countries and the reasons for Canadian companies to use joint ventures. Executives from Canadian companies participating in joint ventures in Latin America seem to perceive the Mexican government's directions to foreign investors as the dominant factor affecting the vehicle of transfer in that country--regardless of whether those directions are explicit, implicit, or indirect. If the Directorate General of Foreign Investments states or implies that the joint venture is appropriate, then joint ventures will be adopted.

The position is perceived to be less dogmatic in Brazil and Colombia. Brazilian authorities (INPI) have preferred to direct rather than to regulate, with the result that Canadian businessmen feel they have somewhat more room to manoeuvre in their choice of a vehicle for technological transfers. In the case of Colombia, government views take the form of an explicit and precise diktat, but there is some scope for negotiation and suasion over general regulations, especially when transferors offer long-term, fade-out provisions as part of a proposed agreement.

In Peru, indirect and implicit forms of pressure are perceived to be more important than explicit governmental directions. In any case, there are very few of the latter, and their implementation time is lengthy. Unless there is indirect disapproval, it seems that a joint venture can operate quite reasonably under conditional, interim permissions. Alternatively, a new transferring venture can be nominally incorporated in one of the more tolerant ANCOM regimes and can then operate freely for a long, introductory period in Peru (or Colombia) ostensibly as a Bolivian or an Ecuadorian company.

In Chile there are few regulations to discourage foreign investment and, therefore, little government pressure for foreign transferors to set up joint ventures. This policy was one of the main reasons for Chile's withdrawal from the Andean Pact, and it is entirely consistent with the general philosophy of the current government. While we were visiting Chile, we attended a UNIDO-sponsored Fora Inversionistas that had been set up by the government as opportunity for potential foreign investors and technology-transferring visitors, with well organised shopping lists of possible projects in which Chile needed foreign technology and/or capital and would welcome them at almost any price.

In contrast to our earlier conclusions, the interview data suggested that, in general, host government incentives have little direct impact on Canadian company decision to set up a joint venture in any of the five Latin American countries studied. At the same time, access to local funding and preferential discrimination were frequently mentioned as attractive benefits arising from a local identity. This apparent contradiction in the logic of transferors' attitudes may perhaps be reconciled by noting that they attributed such benefits to the positive action and efforts of enterprising local associates, rather than to the munificence of host governments.

While conceptually and theoretically attractive, the idea of participating in joint ventures in order to spread business risks appears to be of little interest to most Canadian transferors. Our interviews suggest that the concept of portfolio-widening had no relevance whatsoever in the context of these Latin American locales--or at least, it was so subordinate a consideration that it was only recalled with the aid of specific prompting in most discussions.

It was interesting to note how little recognition there was among Canadian foreign transferors of the potential benefits that could be obtained for a joint venture through the use of local resources, capabilities and facilities. Canadian respondents suggested that these factors are somewhat important in Peru and Colombia only. In both of these countries, the lack of competent local managerial and marketing skills made the acquisition of whatever skills were available an important matter. Furthermore, influential access by local associates to national sources of power and authority were considered vital elements in the less predictable environments of Peru and Colombia. Some respondents also indicated that a joint-venture partner could give the transferor indirect access to the sources of government capital, preferential treatment, and so on.

The data suggests that in Chile, there are fewer benefits to be derived from use of the joint venture as a mode of technology transfer. Chilean authorities impose few limitations or obstructions to technology transfers. As a result, practically all transfers could be organized by arm's-length licensing or by imports, and Canadian transferors strongly preferred these vehicles to joint ventures. Alternatively, foreign transferors could become involved in transferring through Chilean subsidiaries at whatever level of foreign control they deemed to be appropriate.

In contrast to Canadian transferors of technology, but confirming the above findings, derived above from the literature, regulatory authorities in recipient countries clearly favoured joint ventures as the preferred route of entry for foreign investors and technology. Even Chilean officials, who indicated that control of foreign direct investment was less of a concern than in other countries, were strongly in favour of using joint ventures to achieve technology transfers. Generally, joint ventures are perceived as an effective means of increasing indigenous capabilities, training local managers and technicians, and creating employment. Officials in the more industrialized exporting nations of Brazil and Mexico also noted the importance of access to foreign technology through joint ventures.

In all five countries, interviews with government technology regulators suggested that generating national revenues by broadening the tax base and obtaining specific technology were two other advantages of the joint-venture format. These were, however, secondary to developing capabilities and controlling foreign direct investment. Theoretically, at least, joint ventures help to generate private sector earnings. Our interviews found, however, that recipient governments may be less concerned with creating a national private capital potential for reinvestment than they are with generating potential taxable profits and other earnings.

Mexican and Brazilian officials in particular seemed unimpressed by the merits of the import substitution argument or by the contributions *per se* to general national development that joint ventures could make. Mexico and Brazil have large, industrialized economies, and substitutes or alternatives are available locally for most components and consumer goods. Hence, imports are attractive only if they involve advanced technology or scarce materials.

Furthermore, as those countries have already achieved a considerable size in terms of GDP, any new venture is unlikely to cause much of a ripple in national development, except in highly specific areas of technology. The situation is different for the other three recipient nations. Their smaller and narrower domestic industrial bases are influenced, increased, or broadened to an important extent by a new venture's import substitutes or increases in output.

In sum, while the data from our interviews present a rather varied picture, the differences are attributable to the specific situation of each of the countries studied and serve to confirm the advantages of joint ventures suggested in the first section of this paper.

Conclusion

Joint ventures started in the 1960s as second-best solutions for corporate decision-makers. They were a suspect means of foreign direct investment, partly due to the pro rata argument of dilution of potential earnings from a profitable opportunity. But more important were decision-makers' fears that they would lose their ability to unilaterally direct their operations. These attitudes have weakened somewhat over the years, for the most part as the result of force majeure impositions and directions by host governments, who sought to reduce that unilateral power and to obtain further benefits from foreign operations located within their jurisdictions. In effect, there is now considerable convergence in the attitudes of both experienced foreign investors and host governments vis-à-vis the positive nature of joint ventures in general--even if their motivations may be different.

Since one of the most important factors in the successful transfer of technology is the extent and degree of commitment of both transferors and recipients, then this must be a prescription for a joint association. The commonality of interests and direct working associations imposed by the needs of corporate joint ventures provide a structural framework and discipline that either reinforce the relationship or quickly expose its weaknesses. The preliminary findings described in this paper appear to support this argument.

To conclude, the question of whether joint ventures are an effective vehicle for long-term co-operation in the transfer of technologies has not yet been resolved. It is clear, however, that this mode of transfer provides the means for the reconciliation of LDCs' and MNCs' objectives in the initial stages of technology transfer. This is now widely recognized, even by some governments of the "home" countries of the MNCs. In Canada, the House of Commons Standing Committee on External Affairs and National Defence issued a report on 23 November 1982 where MPs stressed the suitability of joint ventures as a vehicle for technology transfer to Latin American countries. Indeed, one measure the committee recommended was to make public money available to promote joint ventures between small and medium-sized Canadian companies and their counterparts in Latin America. Thus, to the incentives offered by a market response to regulation and uncertainty in LDCs, new incentives created at home make joint ventures even more attractive to MNCs.

Be this as it may, while this study has demonstrated that joint ventures hold the promise of benefits for both partners in a technological transfer, it has also pointed out that they cannot be considered a panacea for the many issues raised by the process of technology transfer.

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22. UNCTAD, Major Issues Arising from the Transfer of Technology to Developing Countries (New York: UNCTAD, 1974); and Guidelines for Study of the Transfer of Technology to Developing Countries (New York: UNCTAD, 1972).
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30. Contractor and Sagafi-Nejad, "International Technology Transfer".

31. UNCTAD, Legislation and Regulations, 15.

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33. E. Aguilar, The Transfer of Technology in Mexico and the Multinational Corporation (Mexico City: CIDE, 1975).

34. Contractor and Sagafi-Nejad, "International Technology Transfer", 119.

35. See for example T. Sagafi-Nejad et al., eds., Controlling International Technology Transfer: Issues, Perspectives and Implications, Book No. 2 in the Technology Transfer Trilogy (New York: Pergamon, 1981); and R.W. Moxon, "The Costs, Conditions and Adaptation of MNC Technology in Developing Countries" in The Economic Effects of Multinational Corporations, edited by R.G. Hawkins (Greenwich, Conn.: JAI Press, 1979), 189-221.

36. For example, according to UNCTAD, Legislation and Regulations, the Registro Nacional de Transferencia de Technologica refuses to authorize payments on trademarks and patents.

37. Vaitsos, Intercountry Income Distribution.

38. Moxon, "MNC Technology in Developing Countries".

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